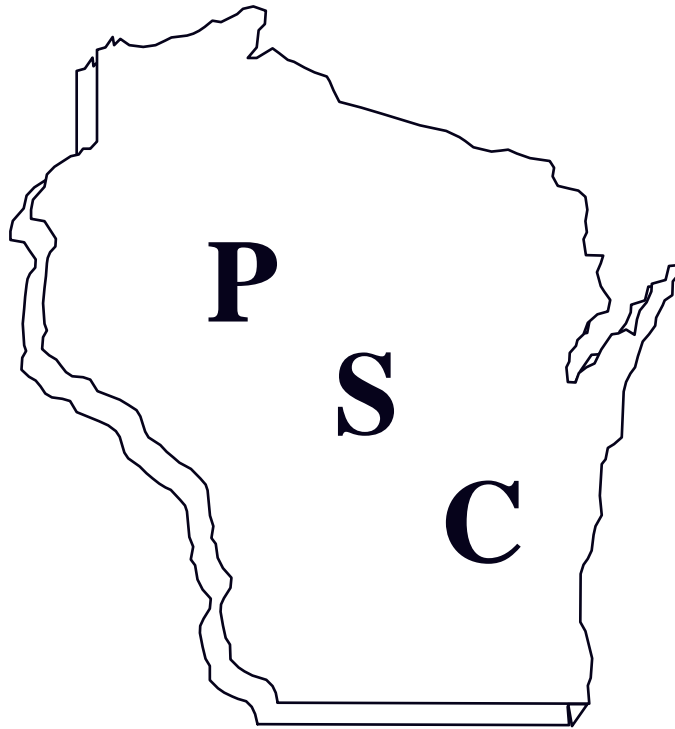


Audit Report on Wisconsin Energy Corporation 2003



**Public Service Commission
of Wisconsin**

Approved by Commission: October 7, 2004

WISCONSIN ENERGY CORPORATION
PUBLIC SERVICE COMMISSION OF WISCONSIN
REPORT TO THE LEGISLATURE

INTRODUCTION

When the Wisconsin Legislature enacted Wisconsin Act 79 in 1985¹ it created legislation regulating the formation and continuing operation of public utility holding company systems in this state. As part of that regulation the Commission is required to submit a report to the legislature on the impacts of the holding company system, both beneficial and adverse, on its public utility affiliates and their investors and consumers.² Periodic audits are also required by statute. An audit was recently completed and serves as the basis for much of this report.

This report describes the holding company system, its impacts on the utilities encompassed by it, as well as any impacts on investors or consumers. A summary of the audit report's major findings is attached to this report. The complete audit report is on file at the Public Service Commission, available upon request.

Wisconsin Energy Corporation

Wisconsin Energy Corporation (WEC) was incorporated in the state of Wisconsin in 1981 and became a diversified holding company in 1986.³ WEC conducts its operations primarily in three operating segments: a utility energy segment, a non-utility energy segment and a manufacturing segment. The Company's primary subsidiaries are Wisconsin Electric Power Company (WEPCO), Wisconsin Gas Company (WGC) and WICOR Industries, Inc (WICOR Industries).⁴

The utility energy segment consists of: WEPCO, which serves over 1,000,000 electric customers in Wisconsin and the Upper Peninsula of Michigan, approximately 420,500 gas customers in Wisconsin and about 470 steam customers in metro Milwaukee, Wisconsin; WGC, which serves about 562,000 gas customers in Wisconsin and about 2,400 water customers in suburban Milwaukee, Wisconsin; and Edison Sault Electric Company (Edison Sault), which serves

¹ 1985 Wisconsin Act 79 creating Wis. Stat. § 196.795 was passed in November 1985,

² Wis. Stat. § 196.795(7)(a) see Appendix H.

³ WEC is a holding company formed after November 24, 1985, the effective date of the enactment of Wis. Stat. § 196.795 (the Wisconsin Holding Company Act or WHCA).

⁴ On April 26, 2000, WEC acquired WICOR, Inc. (WICOR). WICOR is the parent of WGC, and of WICOR Industries, an intermediate holding company which holds the stock of several manufacturers of pumps as well as fluid processing and filtration equipment.

WICOR is a holding company formed prior to November 24, 1985. WICOR operates six subsidiaries in two industries: energy services and pump manufacturing. The energy services group contains WICOR's principal subsidiary, its public utility affiliate, WGC and a 33% interest in Guardian Pipeline. WICOR's pump manufacturing group includes Hypro, SHURflo, and Sta-Rite.

approximately 22,000 electric customers in the Upper Peninsula of Michigan. In April 2002, WEPCO and WGC began doing business under the trade name of “We Energies.”

As of January 1, 2002, the non-utility energy segment consists of W.E. Power, LLC (WE Power) and Wisvest Corporation (Wisvest). WE Power was formed in 2001 to design, construct and own the new electric generating capacity included in the WEPCO’s *Power the Future* strategy. Wisvest owns and operates electric generating facilities and has investments in other energy-related entities and assets. The Company is in the process of downsizing the holdings of Wisvest.

The manufacturing segment consists of WICOR Industries, an intermediary holding company, and its three primary subsidiaries: Sta-Rite Industries, Inc. (Sta-Rite), SHURflo Pump Manufacturing Co. (SHURflo) and Hypro Corporation (Hypro), which are manufacturers of pumps, water treatment products and fluid handling equipment with manufacturing, sales and distribution facilities in the United States and several other countries.⁵

Note: Since the time period covered by this report WEC has sold WICOR, Industries⁶, Docket 9401-YO-101. WGC and the 33 percent interest in Guardian Pipeline will be transferred to WEC. WICOR, Inc., containing WICOR Industries, will be sold, subject to several regulatory approvals.

Time Period

The time period covered by the financial section of this report is from 2001 through 2002. The audit report, summarized in Appendix A, focused primarily on 2000-2002 transactions.

Executive Summary

WEC became a diversified holding company in 1986. Since then both the holding company and the legislation regulating it have changed. WEC is attempting to return to “basics” and shed some of its diversified assets. At the same time transmission has been moved out of the public utility and become quasi non-utility and generation can be utility owned, leased from a utility affiliate, or contracted for from an independent power producer. These changes make it difficult to judge the impact of the holding company system on the public utility. It is apparent that some of the financial insulation that existed between the holding company and its public utility affiliates has disappeared (Moody’s Investor’s Services and Fitch Rating’s downgrades of both the holding company and utility). Some of that loss of insulation may be due to the size of the non-utility assets, many of which are excluded from the asset cap limitation under the category of eligible assets. The public utilities have been able to maintain a separate financial rating that

⁵ Hypro is involved in the manufacture and distribution of agricultural spraying and marine engine cooling pumps. SHURflo manufactures and distributes recreational vehicle pumps, beverage and marine pumps. Sta-Rite manufactures and distributes residential water well and swimming pool pumps. The manufacturing group has manufacturing plants in Australia, Canada, France, Italy, Mexico, New Zealand and the United States, as well as, sales/distribution centers in Australia, Canada, France, Italy, Mexico, New Zealand, Russia, Singapore, United Kingdom and the United States

⁶ The sale of WICOR, Industries was finalized on July 31, 2004.

is higher than the holding company. There doesn't appear to be a significant impact on competition by the existence of the holding company. The Wisconsin public utilities are in the last years of a five year rate freeze associated with the 2000 WICOR acquisition so any impact on rates is unknown at this time. Nor is there any apparent impact on maintenance of the utility system; the maintenance dollars are for the most part declining but there has been no corresponding increase in the number of service complaints. There are several compliance problems associated with the holding company system.⁷ However, none of them have any immediate adverse effect on the public utility affiliate.

Holding Company System Impact

Since 1985 public utilities have been allowed to diversify by forming holding companies. Diversification was promoted as an economic development tool. Therefore, the holding company statute contains conditions requiring the non-utility activities of a public utility holding company to promote business activity, employment, and business capital within the state. Opponents to public utility diversification raised concerns regarding the impact of diversification on the public utility and the public interest. To ensure the integrity of the public utility and protect the interest of its ratepayers, shareholders and the general public, the statute conditions approval of public utility holding companies on:

- continued regulation of the public utility and its interactions with its affiliates (allocation of costs, reasonable rates, affiliated interest approval, access to books and records);
- maintenance of a competitive environment (non-utility activities should not lessen competition, restrain trade, create a monopoly or constitute unfair business practice); and a healthy public utility (maintenance of management focus on the provision of utility service, maintaining reliable utility service, maintaining the utility as the predominant business of the holding company system, insulating the utility from activities of the holding company system – no material impact on public utility rates, cost of capital or ability to raise capital).⁸

This report summarizes the impact the WEC holding company system has had on its public utility affiliates, WEPCO and WGC, its shareholders and the public interest. The discussion addresses, among other things, the size of the non-utility businesses, financial impacts, impact on the utility rates and reliability of service, and impacts on competition.

Size of Nonutility Business

The holding company act as originally drafted required the provision of “reasonably priced and reliable public utility service” be the predominant business of a public utility holding company system.⁹ This was accomplished through the asset cap portion of the statute.¹⁰ The asset cap restricts the sum of the assets of all non-utility affiliates to the sum of 25 percent of electric

⁷ Holding company audit report, which is summarized in Appendix A

⁸ Section 1(7) of 1985 Wisconsin Act 79 - see Appendix H for detail.

⁹ Section 1(7)(f) of 1985 Wisconsin Act 79.

¹⁰ Wis. Stat. § 196.795(6m)(b) – note in 1999 Wisconsin Act 9, Wis. Stat. § 196.795(5)(p) was renumbered Wis. Stat. § 196.795(6m)(b).

utility and 25 percent or more of the assets used to provide other utility services (i.e., gas and steam). The Commission's formation order for WEC, docket 9402-YO-100, set the level of nonutility assets at 25 percent for the steam and gas utilities.

The assumption of utility predominance in a holding company structure was affected by the passage of asset cap relief. In October 1999, Wisconsin Act 9 (Act 9) created Wis. Stat. § 196.795(6m)(e). This provides a public utility holding company partial relief from limits on non-utility assets it may own if the electric utilities in the holding company system transfer their electric transmission facilities to a separate transmission company under Wis. Stat.

§ 196.485(5)(b).¹¹ A category called "eligible assets" was created. Eligible assets are assets in qualified non-utility investments that are excluded from the calculation of the asset cap (see discussion of regulatory change).

Table 1 summarizes the relative size of nonutility assets from 1997 through 2002. The passage of Act 9 in late 1999 substantially changed the calculation of the percentage of nonutility assets, therefore comparisons between years should be limited to 1997 through 1999, with a separate comparison for 2000 through 2002. Since 2000 the percentage of nonutility investments (non-eligible assets) has declined.

Table 1
Wisconsin Energy Corporation
Utility and Nonutility Assets

	1997-2002 (millions)			<u>1999</u>	<u>1998</u>	<u>1997</u>
	<u>2002*</u>	<u>2001*</u>	<u>2000*</u>			
Consolidated WEPCO and utility subsidiaries	6,370	6,088	6,087	5,128	4,839	4,667
Consolidated non-utility affiliates and WEC	<u>342</u>	<u>369</u>	<u>426</u>	<u>1,184</u>	<u>579</u>	<u>414</u>
WEC consolidated	6,712	6,457	6,513	6,312	5,418	5,081
Investment percent	5.37%	6.06%	7.00%	23.09%	11.97%	8.87%
25% of total combined utility assets	1,593	1,614	1,522	1,282	1,210	1,167

* Excluding eligible assets under Wis. Stat. § 196.795(6m).

Financial

Wis. Stat. § 196.795(5)(g) provides that no holding company system may be operated in any way which materially impairs the credit or ability to acquire capital on reasonable terms of any public utility affiliate in the holding company system.

¹¹ Effective on January 1, 2001, WEPCO and Edison Sault Electric Company (Edison Sault) transferred their electric transmission system assets to American Transmission Company LLC in exchange for equity interests in this new company. As a result of the transfer of these assets, WEC meets the criteria for the partial relief provided under Wis. Stat. § 196.795(6m)(e) from the limits on non-utility assets pursuant to Wis. Stat. § 196.485(5)(b).

Credit Ratings

Table X1 (Appendix C) contains the bond and security ratings history for Wisconsin Energy Corporation for the years 1998 through 2002.

In March of 2001, Moody's Investors Services (Moody's) lowered the ratings for Wisconsin Energy and confirmed the ratings for its utility subsidiaries. Since the end of the audit period, Moody's put WEC and its utility subsidiaries under review for a downgrade in February of 2003, and then in October of 2003, Moody's downgraded the ratings for WEC and its subsidiaries.

In October 2003, Fitch Ratings also downgraded WEC and its utility subsidiaries with a stable outlook.

Ratings from Standard and Poor's for WEC and its utility subsidiaries have remained stable except for downgrading the preferred stock.

WEPCO and WGC have a higher credit rating than WEC due to regulatory insulation that requires WEPCO to maintain a specified equity component in its total capitalization.

Commission-Imposed Requirements

In its order in docket 9402-YO-100, the Commission found that the fundamental requirement for meeting the obligation to serve at reasonable cost is the continuing financial health of the utility. The Commission found that three elements of utility finance help to ensure that utilities are able to provide reliable, low cost service into the future:

1. A reasonable and balanced capital structure;
2. A dividend policy based on the utility's needs;
3. A commitment to fund capital construction needed to provide reliable and safe utility service.

1. Reasonable and Balanced Capital Structure

Table X2 (Appendix C) contains the year-end capitalization dollars and percentages for WEC and its utility subsidiaries. For each entity, two capitalizations are shown. The first is the booked capitalization. This contains the companies' securities that are recorded on the balance sheet. However, not all indebtedness is recorded on the balance sheet. In light of recent concerns regarding the amount of off-balance-sheet indebtedness, the second capitalization incorporates adjustments for off-balance-sheet obligations. The off-balance-sheet obligations consist of 60 percent of the present value (10 percent discount factor) of purchased power agreements. The significant reduction in Wisconsin Energy common equity in 2000 was due to the acquisition of WICOR and the deduction of goodwill related to that acquisition from common equity.

Table X3 (Appendix C) contains additional financial statistics. The 2000 data reflects the following: the WICOR acquisition; non-recurring charges related to the WICOR acquisition including severance, benefits, and other costs; announced divestiture of certain non-core

businesses or the write-down of certain non-utility investments; increased fuel and purchased power expenses due to increased generation and significantly higher natural gas prices; and cooler than normal summer weather.

2. Dividend Policy

In prior rate orders the Commission has determined that off-balance-sheet financing should be included when determining appropriate debt and equity levels for public utilities, but not in setting utility rates. In its order in docket 6630-UR-111, dated August 30, 2000, the Commission found that a reasonable utility rate making capital structure for the 2000 and 2001 test years consists of 53.45 percent common equity, 0.86 percent preferred stock, 42.61 percent long-term debt, and 3.08 percent short-term debt. When consideration is given to the off-balance-sheet financing in the test year, the utility financial capital structure will consist of 50.80 percent common equity, 0.81 percent preferred stock, 45.48 percent long-term debt and debt equivalents, and 2.91 percent short-term debt. The Commission found that both the financial and the rate making capital structures were reasonable for the test year.

The Commission determined that assessing the reasonableness of the utility's capital structure depends upon three important principles. First, capital structure decisions must be based on the utility's needs, not on the needs of the nonutility operations of the holding company. Second, the capital structure should provide adequate flexibility to the utility and to the Commission to allow proper utility investment now and in the future. Third, the dividend policy of the utility should not exceed typical electric utility dividend practices as whenever the utility is below the estimated test year common equity ratio.

The utility's needs must take precedence over nonutility needs if ratepayers are to be protected. Wis. Stat. § 196.795 clearly requires the Commission to protect ratepayers from utilities that grant a higher priority to nonutility needs. The identification of utility needs goes beyond foreseeable needs. The utility must have flexibility to finance both foreseen and unforeseen capital requirements.

In docket 9402-YO-100, the Commission recognized the need to protect ratepayers and to ensure that utility needs are placed before nonutility needs in capital structure and dividend policy choices. Protection of the ratepayers' interest and the utility needs requires a capital structure and dividend policy which maintains the projected test year financial integrity of the utility. This can be partially accomplished by paying no more than a typical utility dividend. Such a dividend policy will serve to maintain the utility common equity ratio near the test year authorized level in the event other forecasts are realized. Attempting to maintain the utility common equity ratio near the test year authorized level is important since ratepayers are paying for that level of equity. Therefore, proper ratepayer protection requires that no dividend payments in excess of those forecasted in a rate case be paid prior to the end of the test year. At the end of the test year, a special dividend may be paid in excess of the forecasted dividends only if the additional payment does not reduce the average rate making common equity ratio below the test year forecasted level (53.45 percent in docket 6630-UR-111).

Similarly, in annual periods subsequent to the test year, ratepayer protection requires that no dividends in excess of a typical utility dividend be paid prior to the end of each year. At the end of each year, a special dividend may be paid in excess of a typical utility dividend only if the additional payment does not reduce the average annual rate making common equity ratio below the test year forecasted level (53.45 percent in docket 6630-UR-111).

This dividend limitation was repeated in a number of orders approving WEPCO's issuance of securities subsequent to the order in docket 6630-UR-111.

In February 2001, to meet additional future anticipated capital requirements and to maintain an appropriate capital structure, WEPCO's Board of Directors authorized a quarterly cash dividend, payable to WEC on March 1, 2001, of \$32.5 million (\$130.0 million on an annualized basis), which was reduced from prior quarterly dividends paid during 2000 of \$44.9 million (or \$179.6 million on an annualized basis). WEPCO's level of cash dividends returned to the 2000 level in 2002. While the actual annual rate making common equity ratio is below the test year forecasted level of 53.45 percent, dividends have been paid at or below the typical dividend level.

In its order in docket 6650-GR-111, dated November 11, 1993, the Commission established a 13-month average equity ratio range of 43 percent to 50 percent for Wisconsin Gas and also required Wisconsin Gas to request Commission approval prior to the payment of dividends on its common stock if the payment would reduce its common equity below 43 percent of total capitalization. In addition, the Commission must also approve any dividends in excess of \$16 million for any 12-month period beginning November 1 if such dividends would reduce Wisconsin Gas's 13-month average equity below 48.43 percent of its total capitalization.

3. Commitment to Fund Capital Construction

Commitments to fund capital construction needed to provide reliable and safe utility service is discussed later in this report.

Impact on Competition

In past reports the impact on competition has been measured by the number of small business related complaints received. For the 2001 and 2002 period Commission staff is not aware of any small business related complaints filed concerning WEC, WICOR, WEPCO or WGC. Nothing has come to Commission staff's attention that would indicate anticompetitive behavior and therefore a negative impact on competition.

Utility Rates

Since the last audit report on WEC in 2000, overall rates of WEPCO's electric utility have increased \$86.2 million (including increases of \$58.7 million for fuel); the gas utility has seen overall rates increases of \$3.6 million. These figures incorporate all ordered rate and fuel changes included in rate orders from the 2001 to 2002 test years. See Appendix D for a breakdown of the changes in rates by rate order and type.

While the utility has experienced increases in rates during the period 2001 to 2002, these increases do not indicate that utility ratepayers have been negatively impacted by the holding company. Rate increases were due to increased fuel and purchased power costs, increased costs due to electric reliability and safety construction, nitrogen oxide remediation costs, and increased costs of natural gas.

As a condition of the approval of the WICOR acquisition, the Commission ordered a qualified five-year rate freeze for WEPCO's electric, natural gas, and steam utility services, and for WGC's natural gas rates. The companies may seek biennial rate reviews during the five-year period limited to recovery for substantial electric reliability projects, the construction of major gas laterals associated with pipeline construction, and material changes due to changes in law. In its order, the Commission found that electric fuel cost adjustment procedures as well as gas cost recovery mechanisms would not be subject to the five-year rate restriction period. A full rate review will be required by the Commission at the end of the five-year rate restriction period.

Reliability of Service

In evaluating a utility's commitment to reliable service, the Commission looks at numerous areas including the volume of service complaints, levels and effectiveness of maintenance, construction expended to upgrade the system, and the level of activity in areas such as least cost planning and transmission planning. The following are comments related to the Commission's review of these areas:

1. Complaints

Complaints received by the Commission related to WEPCO and WGC are shown in Table 2.

Increases in the number of complaints have been mainly related to disconnections and deferred payment agreements. The number of service-related complaints was fairly flat and minimal for the 2001 through 2002 period.

Table 2
Number of Complaints

Year	WEPCO	WGC
1996	974	
1997	1534	
1998	1172	
1999	1578	
2000	1777	482
2001	1635	357
2002	2126*	

*2002 WEPCO inc. WGC

2. Maintenance and Construction Activity

In prior holding company reports a historical comparison of maintenance costs was used to evaluate whether the formation of the holding company had any material effect on the level of utility investments. That historic comparison of the maintenance costs of WEPCO and WGC along with other major Wisconsin utilities has been provided below. However, this comparison is not as meaningful as it was in the past when pre-holding company costs could be compared to post-holding company costs, or when expenditures for companies in holding company systems could be compared to those that were not in such systems. As of 2002, all of Wisconsin's major energy utilities are part of a holding company system. With the divestiture of transmission assets to American Transmission Company (ATC), and the transfer of the operation of the nuclear plants to Nuclear Management Company, the pot of dollars that can be considered comparable is shrinking. In some instances utilities such as WP&L are leasing their new corporate headquarters, affecting the comparability of general plant maintenance. Excluding general plant maintenance in order to keep the various utilities on similar footing will further erode the pot of maintenance dollars being compared.

Total electric maintenance expense per customer for WEPCO, restated in 2002 dollars¹² and excluding nuclear and transmission maintenance,¹³ was \$118.54 in 1998 and decreased to \$117.36 per customer in 2002 as shown in Table 3.

WEPCO's total gas maintenance costs per customer, as shown in Table 4, increased slightly from \$16.45 in 1998 to \$17.62 in 2002 as restated in year 2002 dollars. WGC's total gas maintenance costs per customer, as shown in Table 8, decreased from \$18.07 in 1998 to \$15.00 in 2002 as restated in year 2002 dollars.

Nothing in the trends provides any evidence that the formation of the holding companies has harmed the utilities.

¹² In order to recognize the impacts of inflation on utility costs and make comparisons more meaningful, Commission staff adjusted the reported maintenance and construction costs for each utility to restate the figures in 2002 dollars using the Handy Whitman Index.

¹³ Since nuclear maintenance costs are controllable by WPSC as the operating partner, and transmission costs are controllable by the ATC as of January 1, 2001, these costs were excluded for purposes of this comparison.

Table 3

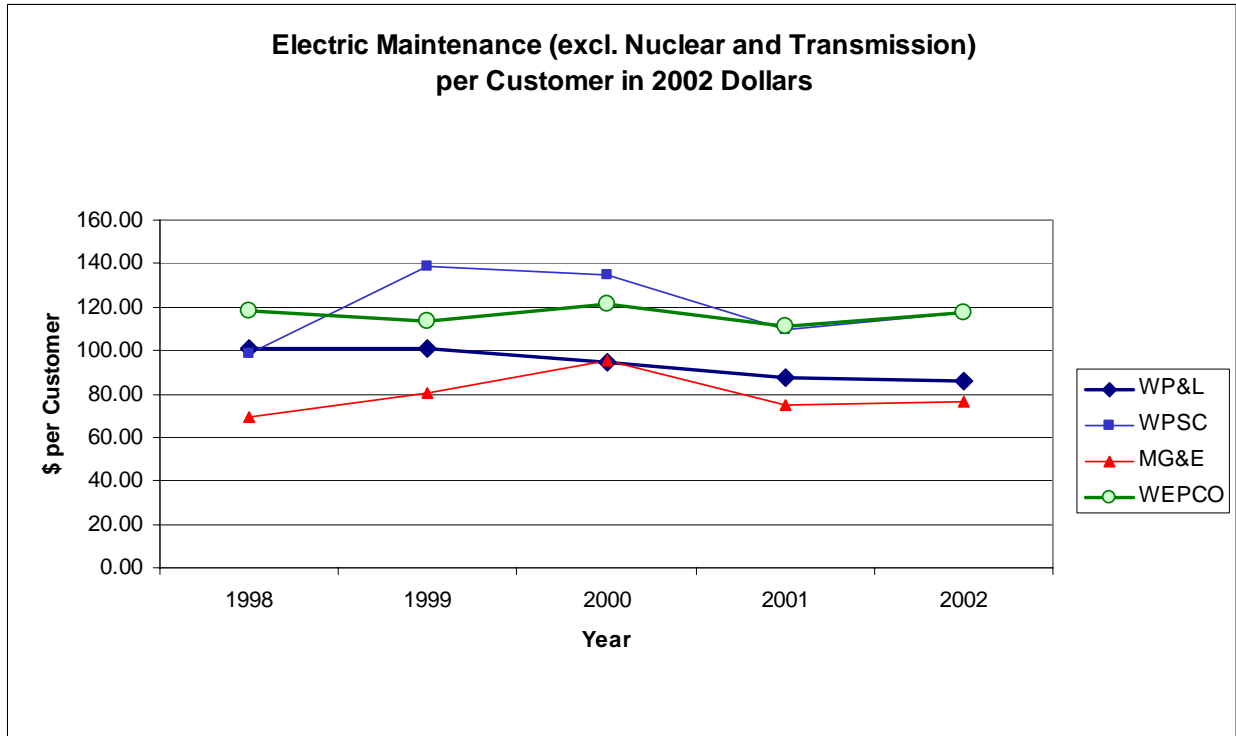
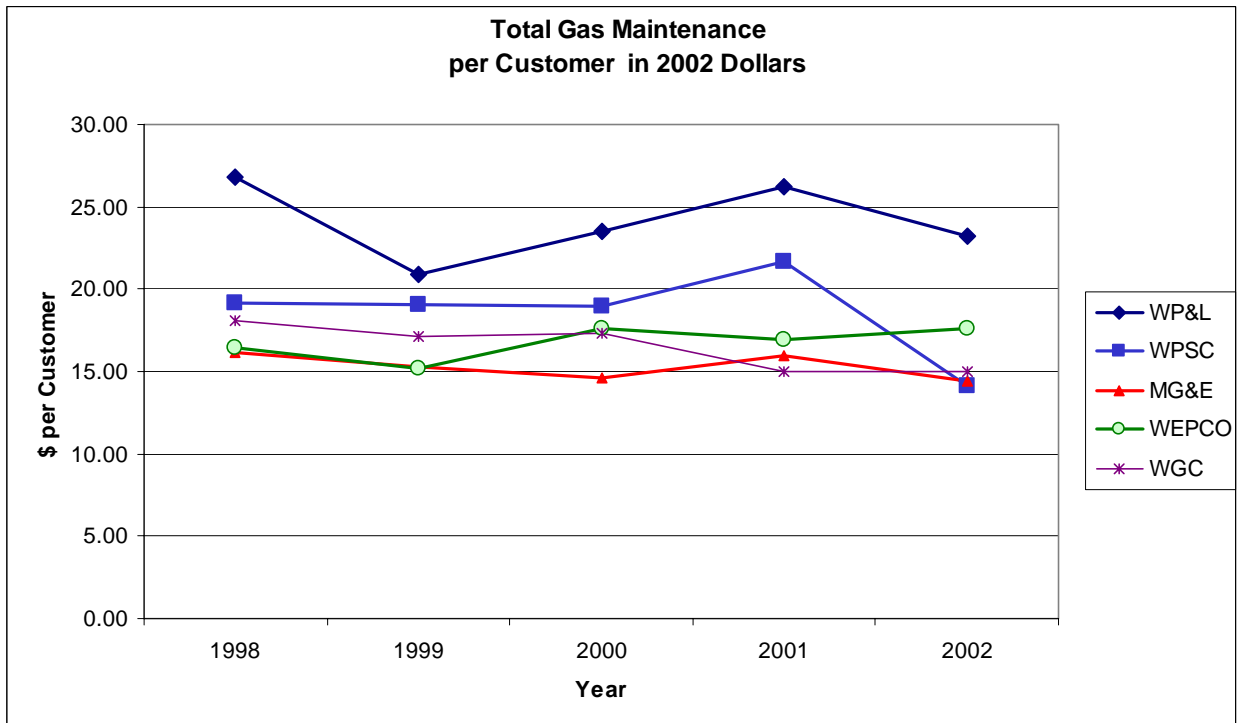


Table 4



3. Planning activity

In 1975, the Wisconsin Legislature created Wis. Stat. § 196.491 that provided an “advance plan” process to inform the Commission and the general public of the electric utilities’ plans to meet their customers’ needs. The Commission’s advance plan process required the utilities to file generation, transmission, and energy efficiency plans every two years for Commission approval. 1997 Wisconsin Act 204 changed the statutes, replacing the advance plan process with a Strategic Energy Assessment (SEA). Investor-owned utilities still provide data every two years, but the Commission prepares the SEA.

Over the years, the Commission has reviewed the utilities’ natural gas supply planning activities usually within the context of the rate case proceeding. On November 8, 1996, the Commission issued an order in docket 05-GI-106, which formalized the review process for gas supply planning. Annually, each gas utility must file a comprehensive gas supply plan for Commission approval. The utility subsidiaries seem to have devoted sufficient levels of resources to plan for its energy supply.

Based upon Commission staff’s review of these three areas through 2002, the reliability of utility service has not been affected by the formation of WEC.

Business of Non-utility Affiliates

As part of the Commission’s investigation of the impact of WEC, a determination shall be made on whether each non-utility affiliate does one of the four items set forth in Wis. Stat. § 196.795(7)(a).¹⁴ Those four items relate to the economic development, functionally related businesses and energy conservation.

WEC conducts its operations primarily in three operating segments: a utility energy segment, a nonutility energy segment, and a manufacturing segment. In addition, WEC has a number of other nonutility subsidiaries and business affiliations. The Company’s primary subsidiaries are WEPCO, WGC, and WICOR Industries, Inc.¹⁵ Copies of various WEC organization charts are shown in Appendix E.

A breakdown of the assets and employees of each nonutility affiliate in total and located in Wisconsin as of December 31, 2002, is included for reference as Appendix F. Investments are based on the balance sheets of each company and are not reduced to reflect the ownership interest of WEC. Therefore, it is not appropriate to total this schedule to determine the percentage of assets and employees located in Wisconsin for the WEC system. The chart is useful in demonstrating that the vast majority of investments and employees are located within Wisconsin.

Appendix G contains a response to Commission staff’s data request from WEC which addresses how the various nonutility affiliates comply with Wis. Stat. § 196.795(7)(a). Appendix G excludes those affiliates obtained by WEC as a result of the WICOR acquisition. Based upon a

¹⁴ See Appendix H

¹⁵ As mentioned earlier WICOR Industries is in the process of being sold.

review of the activities of the nonutility subsidiaries of WEC, all major subsidiaries appear to comply with at least one subsection of Wis. Stat. § 196.795(7)(a). However, some subsidiaries of the major nonutility subsidiaries (the international operations of Minergy, for example), if reviewed on a stand-alone basis, would not reasonably be expected to do any of the things specified in Wis. Stat. § 196.795(7)(a).

Compliance

The holding company audit (summarized in Appendix A) identifies compliance concerns. While none of them have an immediate adverse impact on the public utility, left unaddressed they could have serious consequences.

The audit found numerous issues with the internal audit function. The significance of the audit findings is often minimized; as a result the board of directors may not be aware of the severity of the issue or its potential consequences. There are also issues associated with compliance with recommendations and work paper retention. Weaknesses in the internal audit function could jeopardize internal control and has the potential to affect the accuracy of the corporations' financial statements.

There are numerous findings related to affiliated interest policies and procedures, largely addressing the lack of written policies and procedures and their internal communication. Lack of policies and procedures can lead to internal control weakness, misallocation of expense, regulatory non-compliance, jeopardizing of confidential or market sensitive data, and a lack of corporate direction relating to areas of responsibility. Policies and procedures do not have to be formalized in manuals to be effective but there does have to be a method of ensuring informal policies and procedures are kept current and are communicated to utility and non-utility employees alike.

There are findings regarding changes necessary to properly allocate holding company costs, non-compliance with the master affiliated interest agreement, and failure to adequately address a repeat audit finding related to fair market value. All of these areas have the potential to result in misallocation of cost or errors in cost identification or calculation.

Finally, there are areas where the company and Commission staff do not agree: the applicability of Wis. Stat. §§ 196.52 and 196.795 (Commerce Street Power Plant) and the calculation of goodwill impairment (WGC).

A summary of the holding company audit report is attached as Appendix A. The complete report is available upon request. The complete report contains all audit findings, many of which are minor, but yet necessary to bring to the company's attention and to maintain as a complete record of the audit.

Legislation Concerns

Wis. Stat. § 196.795 allows public utility holding companies to diversify into nonutility investments, limited by an asset cap provision, provided such investments meet one of four criteria under Wis. Stat. § 196.795(7)(a). Act 9 modified the asset cap limitation on nonutility investments of holding company systems, pursuant to Wis. Stat. § 196.795, to allow “eligible assets” to be excluded from the calculation of nonutility assets as a percentage of utility assets. Act 9 did not, however, modify sections 1 through 4 of Wis. Stat. § 196.795(7)(a), defining appropriate nonutility investments. Therefore, an ambiguity exists between what is allowable under the definition of appropriate nonutility investments and the types of investments that qualify for inclusion under the category of “eligible assets.” Not all “eligible assets” will meet at least one of the four criteria of Wis. Stat. § 196.795(7). For instance, WEC’s investments in assets that process waste material, (the international operations of Minergy) as defined in s. 196.01(9m) are considered “eligible assets” but do not meet the criteria in Wis. Stat. § 196.795(7)(a).

If the nonutility investments of a public utility holding company do not, or cannot, reasonably be expected to meet one of the four criteria under Wis. Stat. § 196.795(7)(a), the holding company becomes subject to Wis. Stat. §§ 201.01(2) and 201.03(1) and the holding company is no longer exempt from the definition of a “public service corporation.” Therefore, by reference, Wis. Stat. § 201.01(2) is specifically tied to the criteria in Wis. Stat. § 196.795(7)(a). Since Act 9 did not change or eliminate this reference, investments in “eligible assets” that do not meet one of the four criteria in Wis. Stat. § 196.795(7)(a) have the potential of subjecting the holding company to security regulation by the Commission. As a result, the holding company may not issue securities without Commission approval.

It appears that the only successful way to address the ambiguities is to pursue statutory change. An addition of “eligible assets” as the fifth criteria in Wis. Stat. § 196.795(7)(a), would resolve the problem.

CONCLUSION

This report addressed the impacts of the WEC holding company system, both beneficial and adverse, on its public utility affiliates, investors and consumers. While some compliance concerns were noted there is no evidence that the existence of the WEC holding company system has significantly harmed or benefited the public utility affiliates contained therein, its investors or consumers.

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Public Service Commission of Wisconsin

Summary of

Audit Report on Wisconsin Energy Corporation

2001-2002

**Public Service Commission of Wisconsin
Summary - Audit Report on Wisconsin Energy Corporation
2001-2002**

Objectives and Scope of Audit

Traditionally the overall purpose of a holding company audit is an examination of the operations of the holding company and affiliated transactions for compliance with Wis. Stat. § 196.795. Affiliated transactions between the public utility affiliate and nonutility affiliates including the parent corporation (the holding company) are reviewed to determine the reasonableness of cost allocation methods, reasonableness of pricing methods, and benefit to ratepayers.

This audit used a traditional audit approach and added elements of a managerial audit (documentation and policy compliance) to test for compliance with Wis. Stat. § 196.795. The audit focused on subsidization and allocation issues (small business and competitive concerns) in addition to the traditional compliance with reporting requirements.

Summary of Audit Findings and Recommendations (minor areas not included)**I. Documentation of Affiliated Relationships**

Issue: Policies and procedures were examined to ensure that they defined the nature of the relationships between affiliates, met the applicable legal, regulatory and contractual requirements and were consistently followed.

Findings: WEC lacks sufficient documentation of internal organization and direction, and policies with regard to affiliated interest agreements.

Recommendation: WEC should develop, implement and regularly update methods for monitoring affiliated interest agreements for compliance with legal, regulatory and contractual requirements.

II. Cost Allocation Methodologies

Issue: Documented cost allocation methodologies provide for the appropriate allocation of common and joint costs between affiliates. Cost allocation methodologies should meet applicable legal, regulatory and contractual requirements and should be consistently followed by all affiliates.

Findings: Cost allocation manuals or related directives are not updated regularly. Some costs are not allocated appropriately which can result in the utility paying more than appropriate.

Recommendation: Allocation manuals should be updated regularly to provide a proper allocation basis for payroll, other expenses, and board of director costs.

III. Affiliated Transaction Pricing

Issue: Appropriate affiliated transaction pricing should ensure that regulated utility customers are not disadvantaged. Using the lower of cost or market when the regulated utility is purchasing from the affiliate and the higher of cost or market when the affiliate is purchasing from the utility will accomplish this goal. Also a competitive bid process that is equitable to all qualified bidders will help to ensure appropriate affiliated transaction pricing.

Findings: There is a lack of documentation to justify transactions with affiliates. There is a lack of consistency with respect to the determination of Fair Market Value (FMV) which is used to determine whether transactions with affiliates are appropriately priced. This is a repeat finding. Overhead loadings are estimated and never true-up.

Recommendation: Better documentation when transacting business with an affiliate is necessary including the development and upkeep of FMV studies for all areas. A process should be in place so that overheads are true-up if actuals vary materially from the estimates.

IV. Internal Audit Function

Issue: Proper internal control is a key element within any corporate structure. Ultimately, it provides assurance with respect to operations and solvency. It is crucial that Internal Audit be independent, reporting to the Board of Directors' Audit Committee.

Findings: Oftentimes the ranking assigned to the audit to signal its seriousness has been downplayed. As a result, the Board of Directors may not be made aware of findings that are serious. Other findings were noted including the lack of follow-through on Internal Audit recommendations. Internal Audit is in the process of changing policies and procedures. Until that process is finalized it is difficult to determine whether those changes will address Commission staff's areas of concern and ensure the required independence of Internal Audit.

Recommendation: The company should exercise care when implementing new internal audit policies and procedures so that the independence of the Internal Audit department is not jeopardized. Policies and procedures should ensure that the internal audit reviews are well documented, that recommendations are followed, and findings are appropriately categorized. Internal audits reports to the audit committee should be well documented.

V. Internal Audit's Review of WEC Lease Accounting

Issue: Internal Audit conducted a review of a number of company leases to determine if they were classified correctly as operating or capital leases.

Findings: Commission staff 's review of that internal audit raised concerns with the company's understanding of Commission policy regarding leases, questioned justification that there wasn't sufficient business risk to warrant further investigations relating to the three leases identified by internal audit, and indicated that Internal Audit's recommendations in this area were largely disregarded.

Recommendation: The Company should follow Internal Audit's recommendations regarding further investigation of the three leases and the Controller's Accounting Order No. 166. Given the significant misunderstanding regarding the Commission's lease policy, the company should establish a process for testing all corporate leases, ensuring proper classification.

VI. Internal Audit Investigation – Non-Billings

Issue: The Commission received a complaint that alleged there were significant non-billings in the Kenosha area and that the internal audit report relative to the subject would not be issued. In order to address this complaint Commission staff interviewed the person making the allegations and one of the customers involved. Commission staff asked additional questions of Internal Audit relative to their procedures, policies, staffing, independence, etc., as well as examining the past and present audits conducted and being conducted by Internal Audit. An internal audit related to large customer billings was identified as being the audit referred to in the complaint.

Findings: Commission staff verified that the audit report was issued. It was identified as a category 3 audit (generally well controlled – has one or more areas needing improvement). The report contains no indication of the magnitude or seriousness of the problem. Based on Commission staff's review there is nothing that indicates the seriousness of the problem was discussed with senior management. Failure to properly categorize or indicate the seriousness of the problem risks generating the necessary attention from senior management. This was a case in which numerous customers in multiple billing districts had not been billed for an extended period of time (6 years in the instance the PSC investigated). On a going-forward basis, the issue is being addressed by integration of the customer billing system (CSS) with a new paperless work management system (STORMS).

Recommendation: A quarterly report to the Commission updating the progress of the integration should be filed until the problem has been resolved.

VII. Small Business Concerns

Issue: Wis. Stats. § 196.795(5)(dr) prohibits a public utility from providing any nonutility product or service in a manner or at a price that unfairly discriminates against any competing provider. The focus of this portion of the audit was a review of cost allocation methodologies to ensure appropriate allocation of costs between the utility and any nonutility activities.

Findings: The company indicated it would be difficult, if not impossible, to determine all of the programs, activities, products and services provided by the WEC companies that have 'potential

small business competitive implications'. It is possible to track these business lines and important to do so for all areas in which the activity level is material. It is essential that the Commission be able to determine that costs are being properly allocated and that the utility ratepayers are not subsidizing the non-utility activities of the utility or the holding company system thereby giving those entities a competitive advantage over their small business counterparts.

Recommendation: The company should develop the means and mechanisms necessary to identify and track utility and non-utility programs, activities, products and services having small business implications. Policies and procedures should be developed and implemented to ensure proper cost allocation.

IX. Commerce Street Power Plant / Riverfront Power LLC

Issue: This is an extremely complicated set of transactions and relationships that are not easily summarized. On the surface it is simply the sale by WEPCO of a former power plant site (Commerce Street Power Plant) to a third party developer (X). However, X is not entirely uninterested or independent.

Findings: It is Commission staff's opinion that the sale of the property to Riverfront (an X affiliate) by WEPCO had the characteristics of a transfer from WEPCO to Wisconsin Energy Capital Corporation (WECC) facilitated by an interested third party, X. In that case it could be argued that the transaction is between the affiliates WEPCO and WECC and there is the potential for a violation of Wis. Stat. § 196.52.¹⁶ The company's opinion is that Riverfront was not an affiliate of WEPCO at the time of the sale, therefore no violation of Wis. Stat. § 196.52 has occurred. Also, the company states it had marketed the property publicly for a number of years without success prior to the sale. Therefore, even though in their opinion Riverfront was not an affiliate at the time of the sale, there had been a public offering of the property and there is no violation of Wis. Stat. § 196.795(5)(k). They were able to provide little evidence that would support a public offering had been made.

In summary there is not a definitive violation of either Wis. Stat. § 196.52¹⁷ or Wis. Stat. § 196.795(5)(k). In this particular instance there is little apparent harm to the ratepayers.¹⁸ The property was not in utility service at the time of its sale and therefore the proceeds would go to

¹⁶ Wis. Stat. § 196.52(3) requires the consent of the Commission before executing the purchase agreement for the sale of Commerce Street Power plant site (WEPCO and WECC did not have affiliated interest approval from the Commission).

¹⁷ It is Commission staff's analysis that it was questionable whether or not the affiliated interest statute could be applied directly to Riverfront. That statute is written from the perspective of the utility. When the statute speaks of parties or individuals exercising control, it is control over the actions of the utility. In this case it is the ability of WECC, an affiliate of WEPCO, WEC or WEPCO to exert control over Riverfront. WEC owned 100% interest in two of the parties WEPCO and WECC, and a 66% interest in Commerce Power LLC. WECC was critical to the financing of Riverfront and Commerce Power LLC held the necessary parking. This is not the traditional way to view an affiliated interest relationship but realistically WEC could exert control over all of the parties to these transactions.

¹⁸ The only potential harm to the ratepayer is the assumption of the environmental liability by WEPCO and even then it is questionable whether or not WEPCO could have negotiated away that liability with another party.

the shareholders. However, this shows how Wis. Stat. § 196.52 and Wis. Stat. § 196.795 could be circumvented and how difficult a Commission investigation can be. There is the potential for the utility to acquire property or retire utility property early with the intention to transfer to the non-utility affiliate. Should this occur the effects on ratepayers could be significant.

Recommendation: There is no action by the company necessary at this time. Legislative changes could be made in the future to eliminate the potential for circumventing the intent of the statute.

X. WGC Goodwill Impairment

Issue: The company adopted statement of Financial Accounting Standards No. 142, Goodwill and Other Intangible Assets (SFAS 142), effective January 1, 2002. SFAS 142 requires the company to perform annual assessments¹⁹ of its goodwill for impairment by applying fair-value-based tests.²⁰ Based on SFAS 142, when goodwill is impaired, it must be written off.

Findings: The company indicated that Wisconsin Gas Company's goodwill impairment analysis, when aggregated with WEPCO's operations, concludes there is no indication of goodwill impairment. Commission staff reviewed the company's goodwill impairment analysis and questions both the methodology and the results. The company performed their own analysis and did not use a third party valuation expert.²¹ Commission staff's financial analysis of potential impairment at WGC (on a stand alone basis) ranged from \$130 million to \$260 million.²²

Recommendation: The Company should be more diligent in future analysis of goodwill impairment and not hesitate to employ third party valuation experts if necessary.

XI. Potential Meter Tampering

Issue: A complaint alleged possible instances of meter tampering on large industrial gas meters in the former Wisconsin Southern territory. In order to clarify the matter Commission staff asked numerous questions regarding meter history, consumption, work orders, Corporate Security and Energy Theft and Fraud's investigations.

Findings: The company has its own investigation underway. The meter in question has been replaced with a more secure meter and consumption patterns are being monitored.

¹⁹ Depending on conditions more frequent reviews may be required.

²⁰ Under SFAS 142, goodwill and other intangibles with indefinite lives are no longer subject to amortization. Instead, goodwill along with other intangibles are subject to new fair value based rules for measuring impairment and potential write-downs if the carrying value is more than the fair market value.

²¹ Although the standards do not require an independent evaluation there must be a high level of competent analysis.

²² There has been a recent indication on the company's part in discussions with Commission staff regarding the sale of WICOR Industries that there will be a significant write down of goodwill taken at the WGC level.

Recommendation: The company should report on its findings and final determination concerning its investigation to Commission staff. If it is not resolved by September 30, 2004, quarterly status reports should be submitted.

XII. Wispark

Issue: The Commission received information regarding potential misconduct regarding property or property rights transfers between the utilities, non-utility affiliates and officers or former officers of the non-utility affiliate, Wispark.

Findings: Commission staff is conducting an ongoing investigation into these allegations. Although the transactions may not involve public utility affiliates, they have the potential to affect the financial health of the holding company system.

Conclusion

What started out as a compressed audit expanded in response to allegations from external sources. Internal Audit, the department, its policies and procedures as well as its end products were reviewed in detail. While there was evidence of significant lack of necessary written processes and procedures, there were also signs that the company was working to fill those gaps. Internal Audit is an area that should receive greater scrutiny in the future to ensure its independence. It is a critical cog from both a corporate governance perspective and the significant reliance placed upon it by the company's external auditors.

Processes need to be implemented to ensure ongoing compliance with statutes and Commission orders regarding affiliated interests and holding comply issues. This includes proper documentation, effective communication, and proper cost allocation.

As holding company systems change it is essential that the Commission's audit process change to ensure compliance with the statutes. This audit was an attempt to implement such changes. Further change can be expected as both the holding companies and the statutes that govern them evolve.

g:\holding company\reports\WEC\2003 audit report to legislature JJB1

Wisconsin Energy Corporation**2002 Reconciliation of Expenses****Expenses Incurred by WEC**

Billings from We Energies	\$	5,345,584
Accrual to We Energies		612,519
WEC Payroll & Benefits		3,748,233
WEC Vouchers & Accruals		17,973,107
Total Incurred	\$	<u>27,679,443</u>

Distribution of WEC Expenses

Billings to WEPCO	\$	2,188,185
Billings to WG		341,172
Billings to Edison Sault		64,386
Billings to Nonutility Subsidiaries		8,299,003
Allocation to WEPCO		3,649,672
Allocation to WG		672,612
Allocation to Edison Sault		55,550
Allocation to Nonutility Subsidiaries		1,311,600
Retained by WEC		11,097,263
Total Distribution	\$	<u>27,679,443</u>

	4/30/03	12/31/02	12/31/01	12/31/00	12/31/99	12/31/98
Wisconsin Electric Power Company						
WE Corporate Credit Rating						
Standard & Poor's Corp.	A-	A	A			
Utility Bond Ratings (SEC 10-K)						
Moody's Investors Service, Inc.	Aa2	Aa2	Aa2	Aa2	Aa2	Aa2
Standard & Poor's Corp.	A-	A	A	AA-	AA+	AA+
Fitch	AA	AA	AA	AA	AA	AA
Utility Debenture Ratings						
Moody's Investors Service, Inc.	Aa3	Aa3	Aa3	Aa3	Aa3	Aa3
Standard & Poor's Corp.	A-	A-	A-	A+	AA	AA
Fitch	AA-	AA-	AA-	AA-	AA-	AA-
Preferred Stock						
Moody's Investors Service, Inc.	A2	A2	A2	Aa3	Aa3	Aa3
Standard & Poor's Corp.	BBB	BBB+	BBB+	A	AA-	AA-
Fitch	AA-	AA-	AA-	AA-	AA-	AA-
Commercial Paper						
Moody's Investors Service, Inc.	P-1	P-1	P-1	P-1	P-1	P-1
Standard & Poor's Corp.	A-2	A-1	A-1	A-1+	A-1+	A-1+
Fitch	F1+	F1+	F1+	F1+	No Rating	No Rating
Wisconsin Gas Company						
WG Corporate Credit Rating						
Standard & Poor's Corp.	A-	A	A			

Table X1
Wisconsin Energy Corporation
Comparison of Bond and Security Ratings
As of 12/31/98, 12/31/99, 12/31/00, 12/31/01, 12/31/02, and 4/30/03

	4/30/03	12/31/02	12/31/01	12/31/00	12/31/99	12/31/98
Utility Debenture Ratings						
Moody's Investors Service, Inc.	Aa2	Aa2	Aa2	Aa2	Aa2	
Standard & Poor's Corp.	A-	A	A	AA-	AA-	
Fitch	AA-	AA-	AA-	AA-		
Commercial Paper						
Moody's Investors Service, Inc.	P-1	P-1	P-1	P-1		
Standard & Poor's Corp.	A-2	A-1	A-1	A-1+		
Fitch	F1+	F1+	F1+	F1+		
Wisconsin Energy Corporation						
WEC Corporate Credit Rating						
Standard & Poor's Corp.	BBB+	A-				
Senior Unsecured						
Moody's Investors Service, Inc.	A2	A2	A2	A2	A1	A1
Standard & Poor's Corp.	BBB+	A-	A-	A+	AA	AA
Fitch	A	A	A+	A+	-	-
WEC Capital Trust Preferred stock						
Moody's Investors Service, Inc.	A3	A3	A3	A2	A1	-
Standard & Poor's Corp.	BBB-	BBB	BBB	A-	A+	-
Fitch	A-	A-	A	A	-	
Commercial Paper						
Moody's Investors Service, Inc.	P-1	P-1	P-1	P-1	P-1	P-1
Standard & Poor's Corp.	A-2	A-2	A-1	A-1	A-1+	A-1+
Fitch	F1	F1	F1	F1	-	-

Table X2
Wisconsin Energy Corporation
Year-End Capitalizations
1998-2002
(000's)

	1998	1999	2000	2001	2002
Wisconsin Electric Power Company					
Capitalization:					
Common Equity	\$1,698,479	\$1,880,854	\$1,864,805	\$1,980,082	\$2,049,941
Preferred Stock	30,450	30,450	30,450	30,450	30,450
Short-Term Debt	219,289	264,664	256,989	161,463	331,717
Capital Leases	189,980	215,899	215,519	211,363	218,221
Long-Term Debt	1,459,035	1,516,129	1,514,224	1,512,319	1,256,971
Off-Balance-Sheet Obligations (OBSO)		43,261	42,670	110,762	110,700
Common Equity Ratio-Booked Basis	47.22%	48.13%	48.04%	50.83%	52.73%
Total Debt to Capital-Booked Basis	51.94%	51.09%	51.18%	48.39%	46.48%
Common Equity Ratio-with OBSO	47.22%	47.60%	47.52%	49.42%	51.27%
Total Debt to Capital-with OBSO	51.94%	51.63%	51.71%	49.82%	47.96%
Wisconsin Gas Company					
Capitalization:					
Common Equity	\$213,346	\$215,560	\$218,162	\$249,137	\$284,253
Short-Term Debt	65,000	89,759	130,100	128,693	142,182
Long-Term Debt	162,000	160,000	160,000	160,000	160,000
Common Equity Ratio-Booked Basis	48.45%	46.33%	42.92%	46.32%	48.47%
Total Debt to Capital-Booked Basis	51.55%	53.67%	57.08%	53.68%	51.53%
Common Equity Ratio-with OBSO	48.45%	46.33%	42.92%	46.32%	48.47%
Total Debt to Capital-with OBSO	51.55%	53.67%	57.08%	53.68%	51.53%

Table X2
Wisconsin Energy Corporation
Year-End Capitalizations
1998-2002
(000's)

	1998	1999	2000	2001	2002
Wisconsin Energy Corporation					
Capitalization:					
Common Equity (excludes Goodwill)					
Preferred Stock	30,450	30,450	30,450	30,450	30,450
Short-Term Debt	286,859	507,500	1,386,100	550,400	953,100
Capital Leases	189,980	215,899	215,500	215,500	218,200
Long-Term Debt	1,703,317	2,012,262	2,606,700	3,552,600	2,888,200
Preferred Securities		200,000	200,000	200,000	200,000
Off-Balance-Sheet Obligations (OBOS)		43,261	42,670	110,762	110,700
Common Equity Ratio-Booked Basis	46.26%	39.66%	21.14%	21.20%	23.34%
Total Debt to Capital-Booked Basis	53.00%	59.72%	78.32%	78.27%	76.11%
Common Equity Ratio-with OBOS	46.26%	39.32%	20.98%	20.80%	22.89%
Total Debt to Capital-with OBOS	53.00%	60.07%	78.48%	78.68%	76.58%

Sources: 10-K and 10-Q's for Wisconsin Energy, Wisconsin Electric Power Company, and Wisconsin Gas Company, and PSC Annual Reports.

Table X3
Wisconsin Energy Corporation
Selected Financial Statistics
1998-2002

	<u>2002</u>	<u>2001</u>	<u>2000</u>	<u>1999</u>	<u>1998</u>
WEPCO					
Pretax interest coverage ⁽¹⁾	5.39	4.67	3.28	3.87	3.50
Earned return on equity-regulatory ⁽²⁾	11.03%	11.99%	8.41%	11.90%	10.44%
Earned return on equity-financial ⁽³⁾	11.33%	12.35%	8.71%	12.32%	10.86%
U.S. Treasury bond yields-30 year ⁽⁴⁾	5.43%	5.49%	5.94%	5.87%	5.58%
 WGC					
Pretax interest coverage ⁽¹⁾	5.34	1.90	2.13	4.34	3.88
Earned return on equity-regulatory ⁽²⁾	9.81%	5.53%	11.14%	11.97%	10.27%
Earned return on equity-financial ⁽³⁾	9.96%	5.63%	11.42%	12.24%	10.53%
 WEC					
Pretax interest coverage ⁽¹⁾	2.30	2.57	2.21	3.24	3.20
Earned return on equity ⁽⁵⁾	8.10%	10.70%	7.50%	10.70%	10.10%

Sources:

(1) Calculated from Form 10-K to the Securities and Exchange Commission

(2) Form PSC AF 6

(3) Form PSC AF 5

(4) Federal Reserve Statistical Release Website

(5) As reported in the Form 10-K to the Securities and Exchange Commission

WISCONSIN ELECTRIC POWER COMPANY
RATE AND FUEL CASE HISTORY

<u>Service - Wisconsin Electric</u>	<u>Docket Number</u>	<u>Annualized Revenue Increase (Decrease) (Millions)</u>	<u>Percent Change in Rates (%)</u>	<u>Authorized Return on Common Equity (%)</u>	<u>Effective Date</u>
Retail gas (e)	6630-UR-111	11.6			12/19/01
Fuel electric, WI (d)	6630-UR-111	58.7		-	5/03/01
Fuel electric, WI (c)	6630-UR-111	37.8			2/08/01
Retail electric, WI (b)	6630-UR-111	27.5	1.8%		1/01/01
Retail electric, WI (a)	6630-UR-111	36.5	2.5%	12.2%	8/30/00
Retail gas	6630-UR-111	8.0	2.1%	12.2%	8/30/00

(a) The final August 30, 2000, order also approved an annualized increase in retail electric rates of \$27.5 million, effective January 1, 2001.

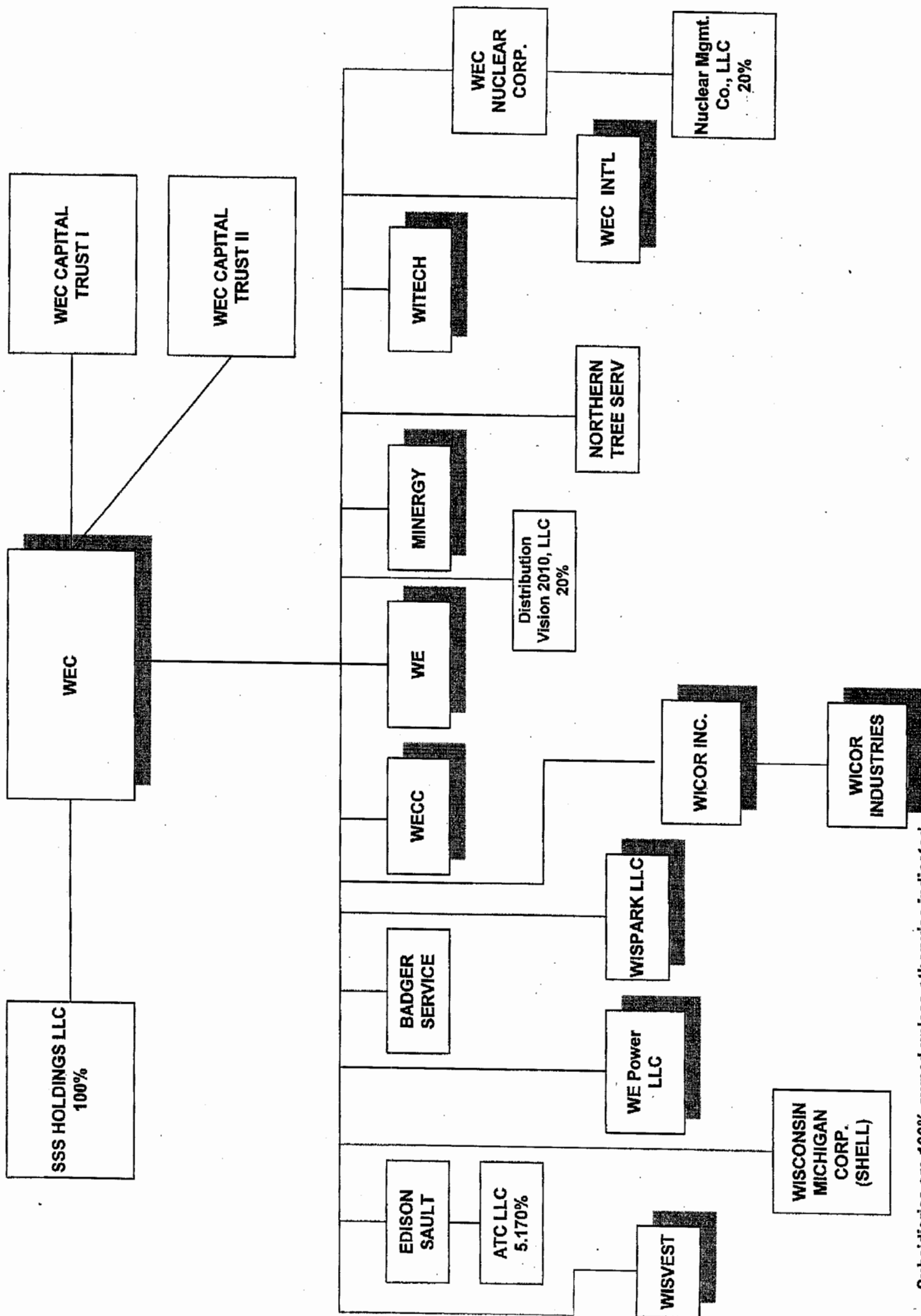
(b) 2001 Step Increase.

(c) Interim fuel surcharge.

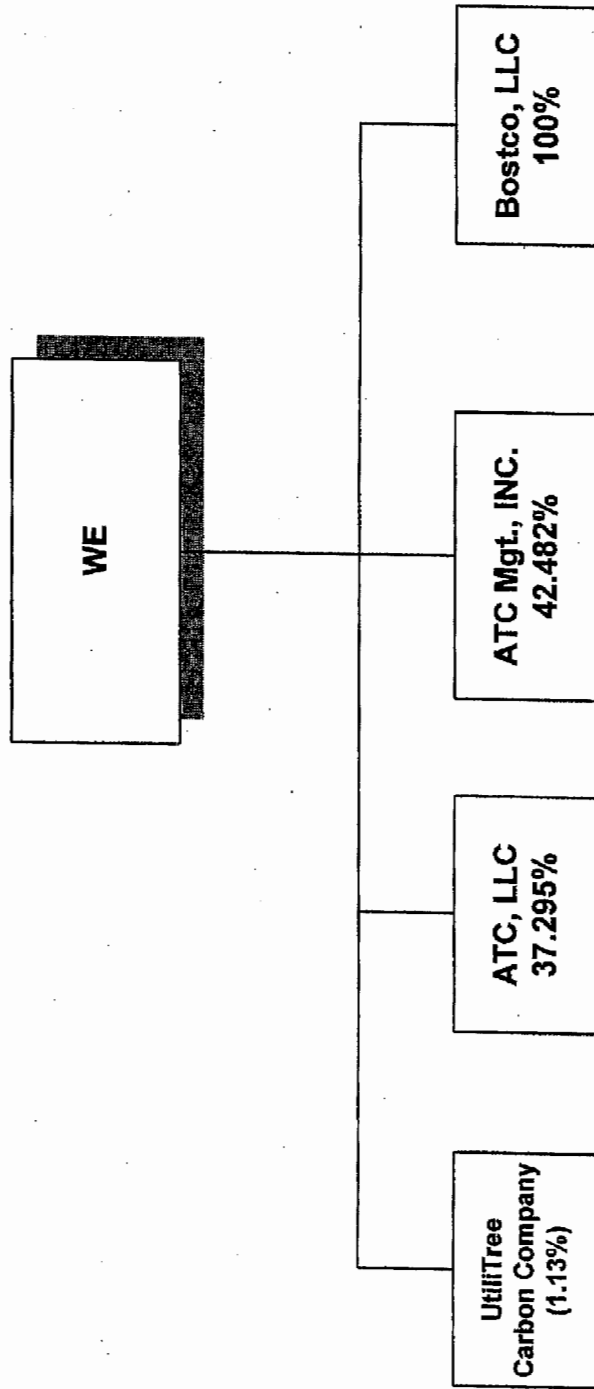
(d) Final fuel surcharge – replaces the 37.8 million interim – is not additive.

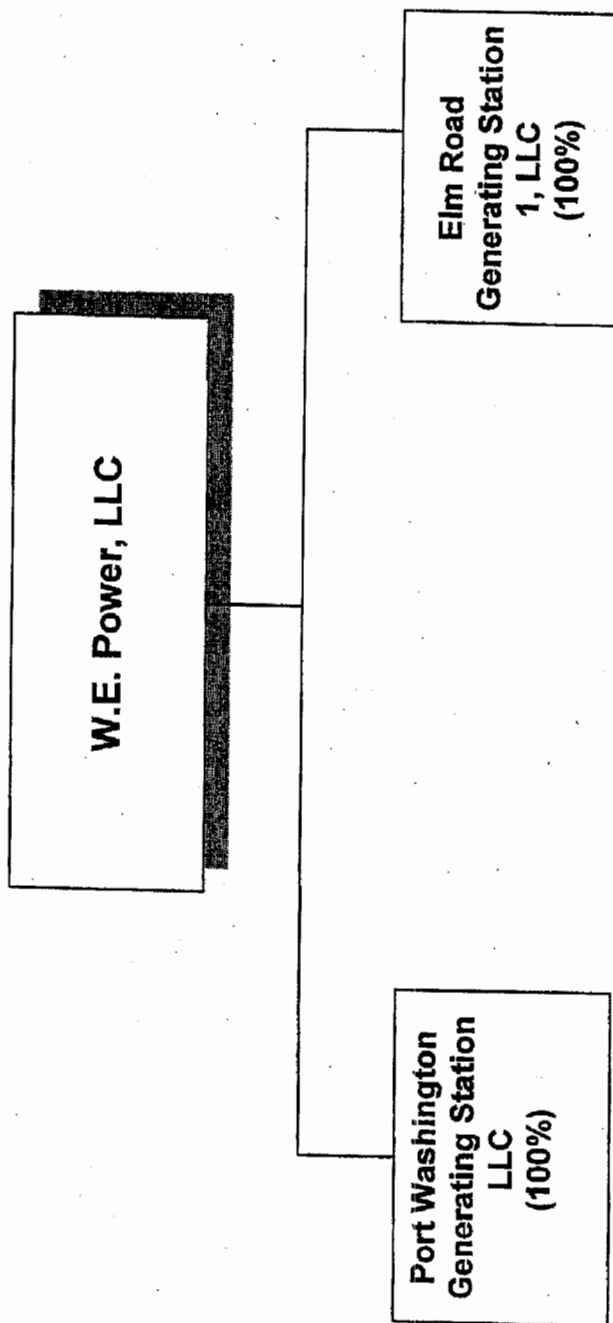
(e) Amended order – replaces the 8.0 million – is not additive.

WISCONSIN ENERGY CORPORATION
ORGANIZATIONAL CHARTS

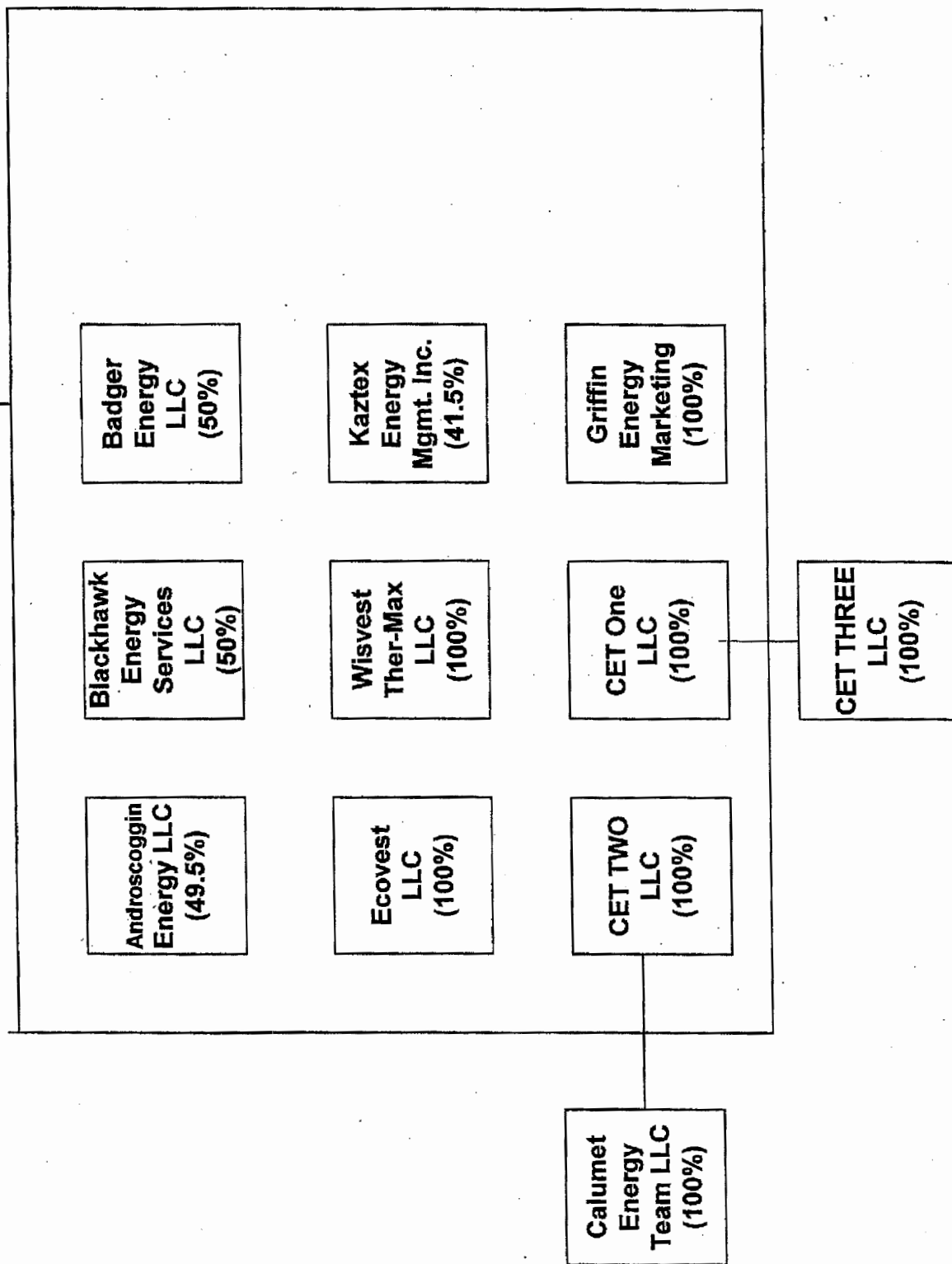


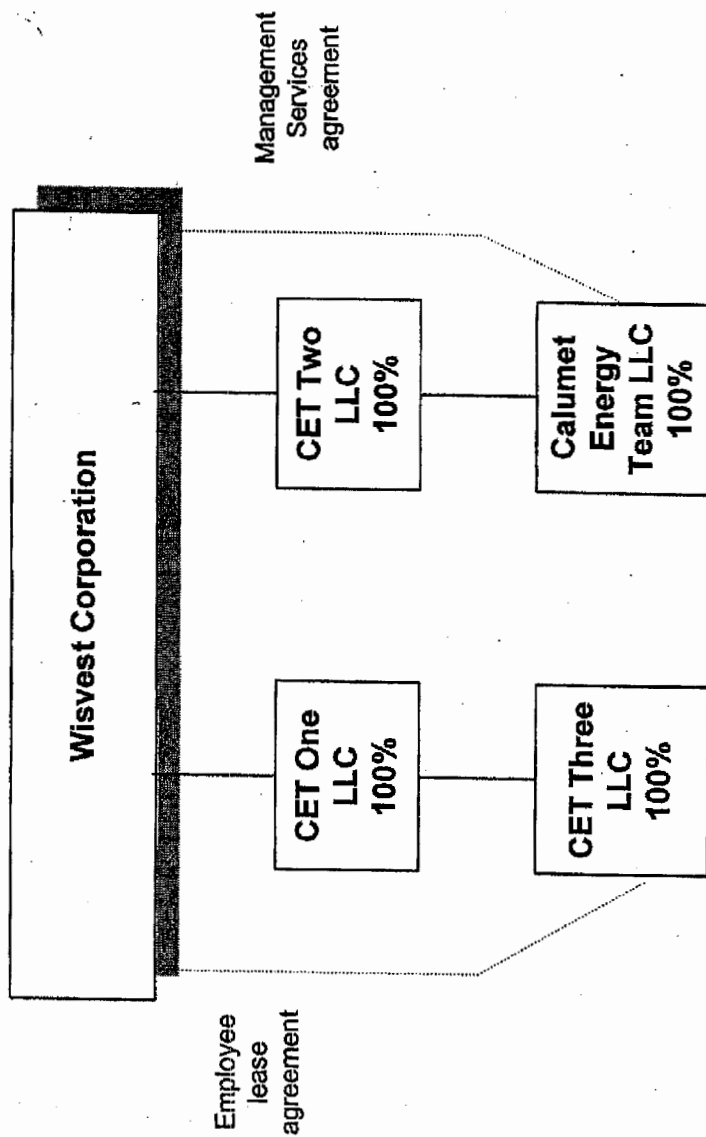
Subsidiaries are 100% owned unless otherwise indicated.
Shadowed corporations have significant interest in other affiliated entities as detailed in subsequent diagrams.

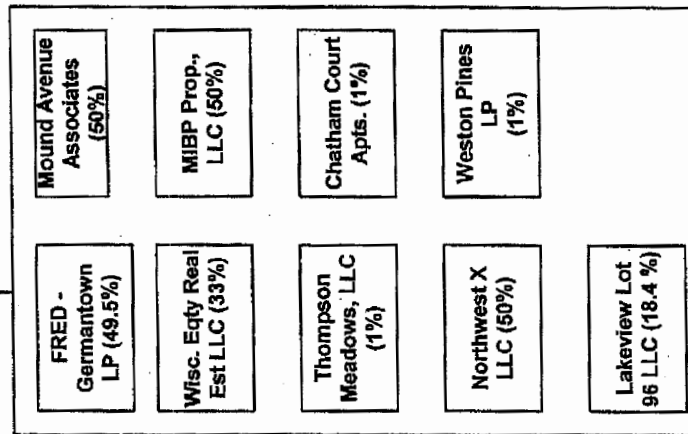
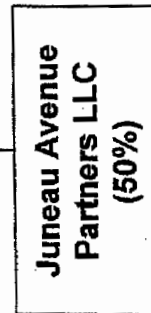
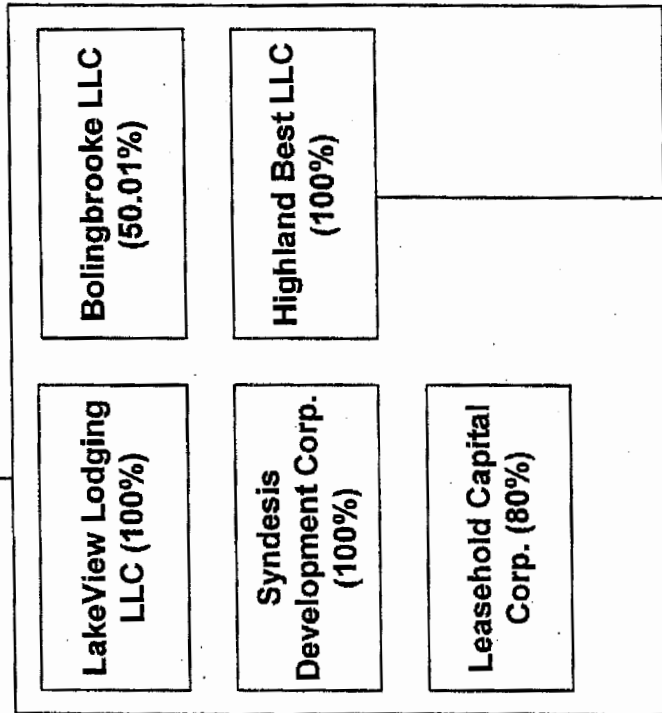
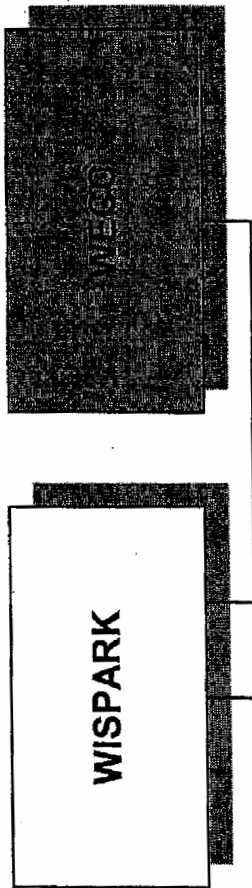




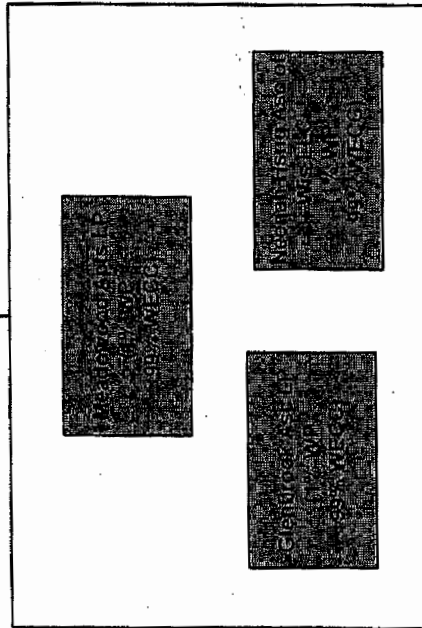
WISVEST

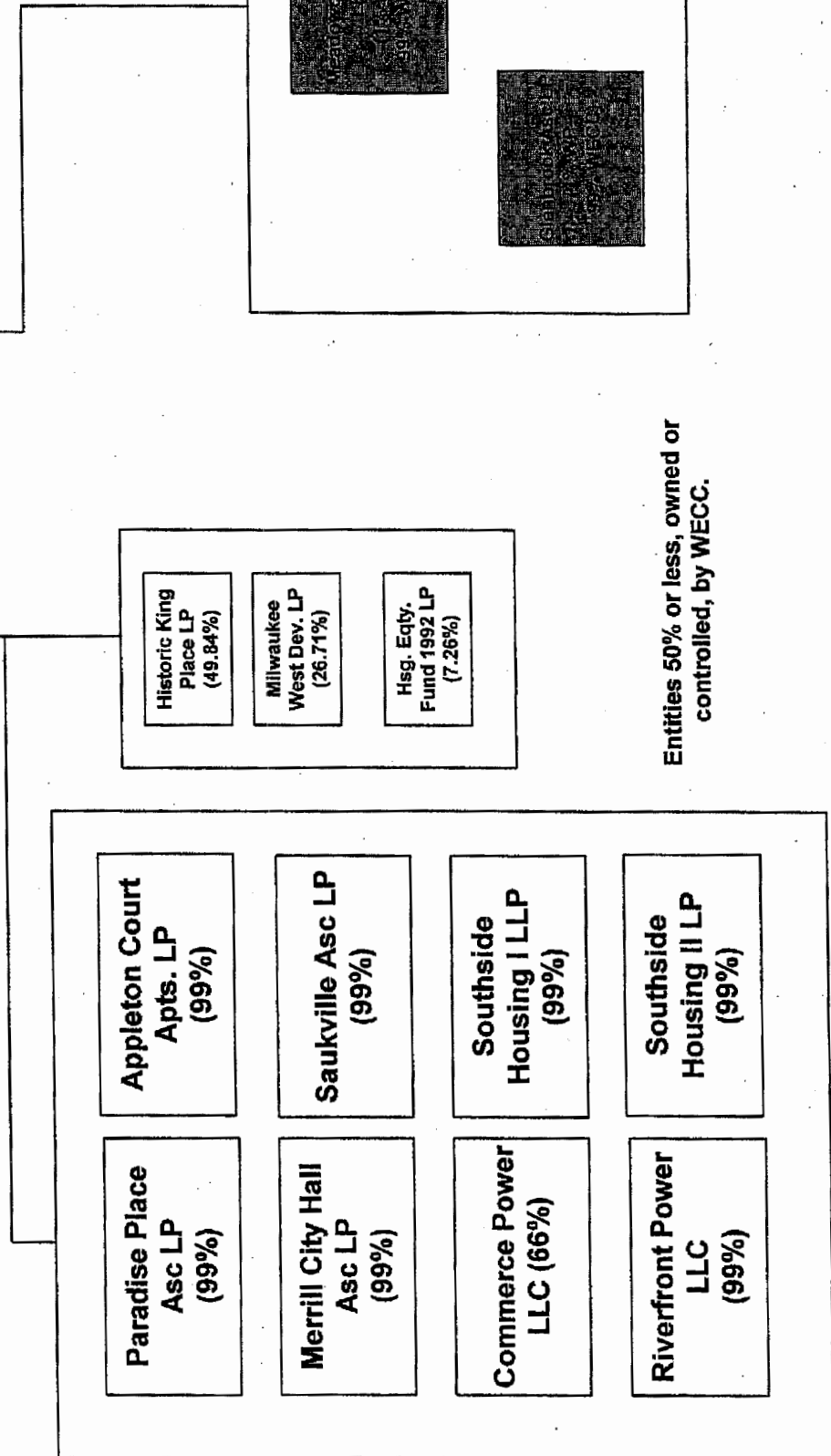
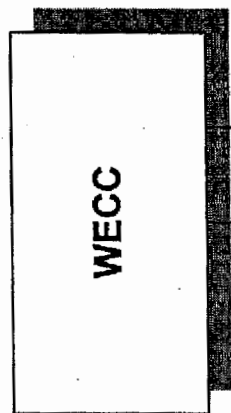


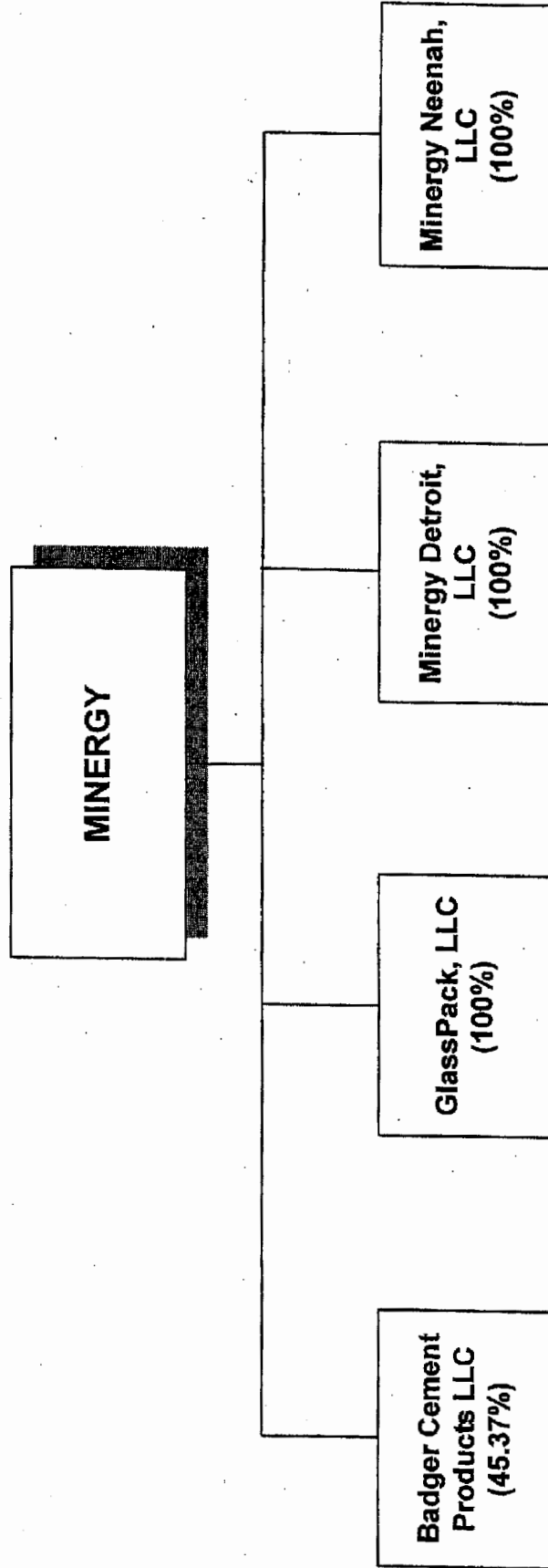


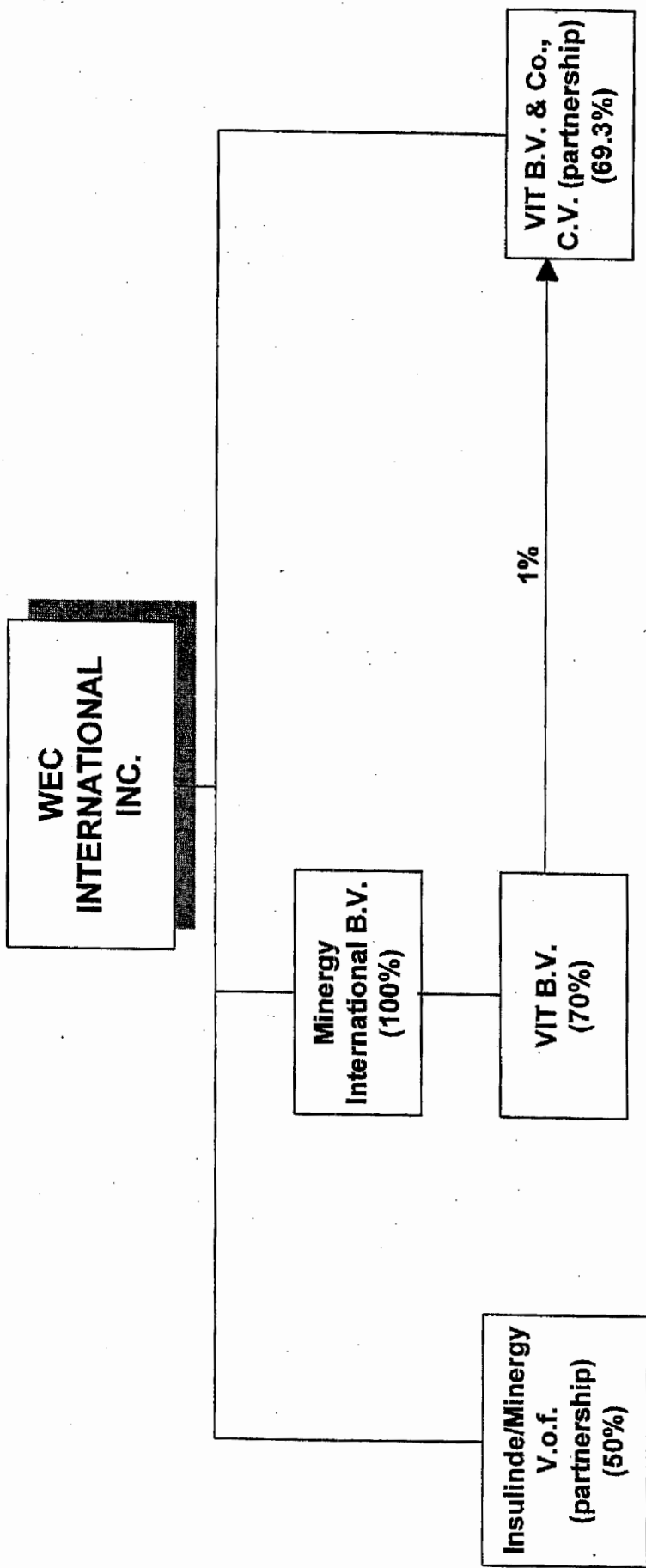


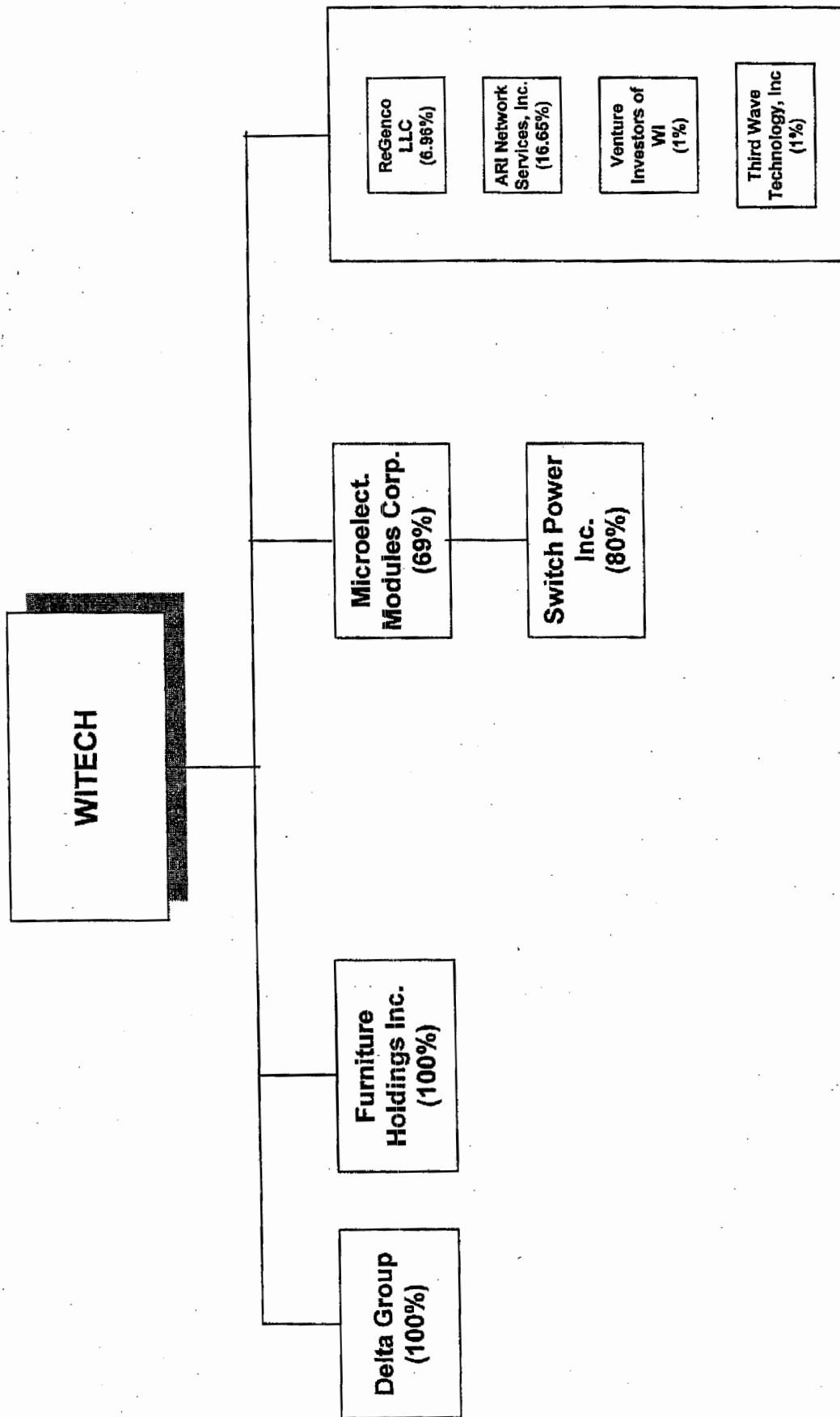
Entities 50% or less, owned or controlled, by Wispark.



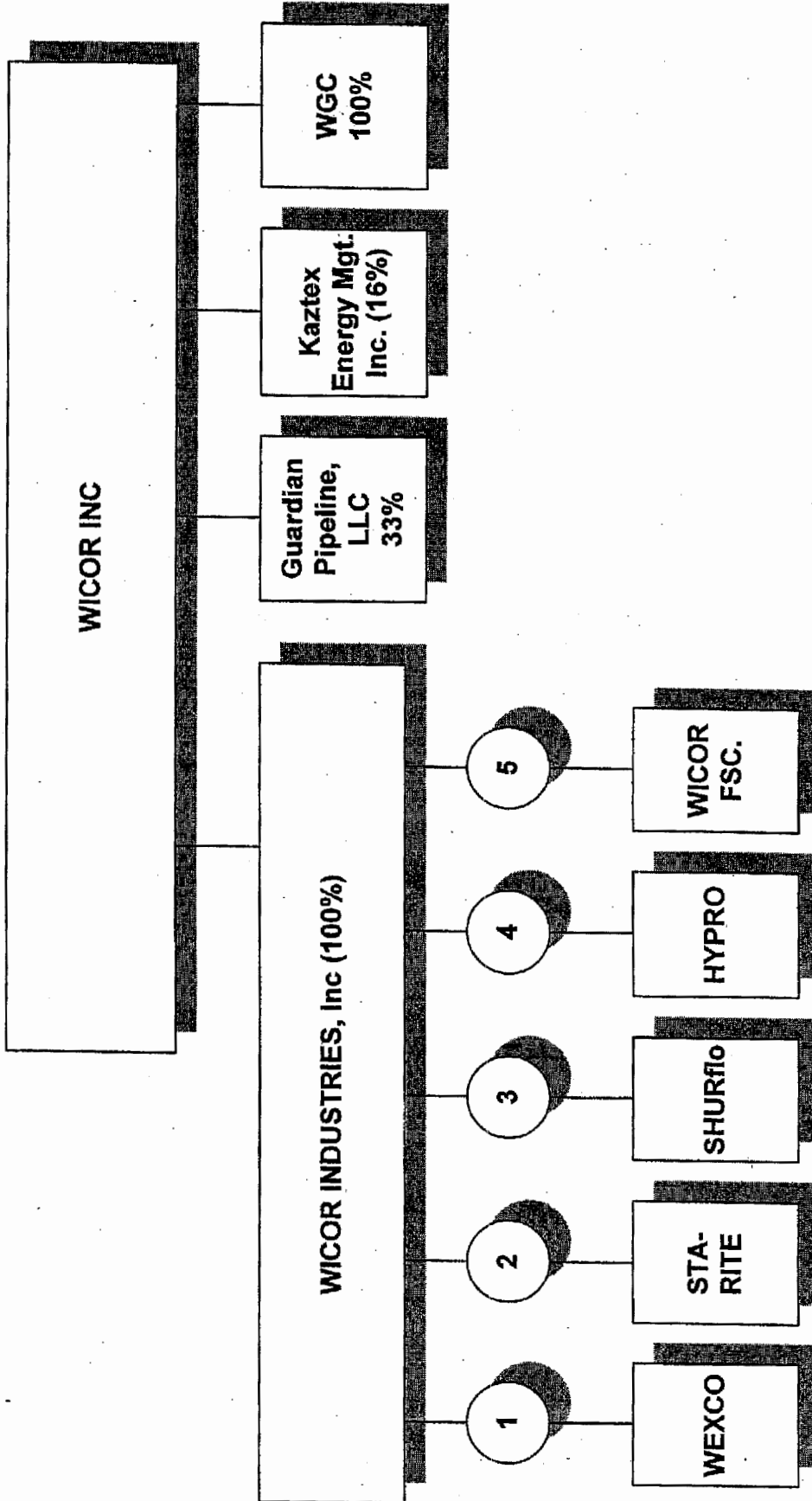








Entities 50% or less, owned or controlled, by WITECH.



Appendix F

Wisconsin Energy Corporation Assets and Employees Total and In-State December 31, 2002

<u>Nonutility Affiliates (A)</u>	<u>Assets (000) (B) (C)</u>		<u>Employees</u>	
	<u>Total</u>	<u>Wisconsin</u>	<u>Total</u>	<u>Wisconsin</u>
Wisconsin Energy Corporation	4,126,534 (D)	4,126,534	24	24
Badger Service Company	2,244	2,244	6	6
Minergy Corp.	50,368	50,368	20	20
Northern Tree Service, Inc.	389	--	15	5
SSS Holdings, LLC	1,338	1,338	--	--
WEC Capital Trust I	206,200	206,200	--	--
WEC Capital Trust II	--	--	--	--
WEC International, Inc.	13	13	5	5
WEC Nuclear Corporation	3,174	3,174	4	4
W.E. Power, LLC	53,902	53,902	25	25
Wisconsin Energy Capital Corporation	431,747	431,747	6	6
Wisconsin Michigan Corporation	--	--	--	--
WISPARK LLC	151,108	129,304	16	16
WISVEST Corporation	301,680	301,680	26	21
WITECH Corporation	1,582	1,582	7	7
Bolingbrooke Associates, LLC	8,747	--	--	--
Bostco LLC	31,055	31,055	6	6
Calumet Energy Team, LLC	158,939	--	--	--
CET One, LLC	2,762	--	--	--
CET Two, LLC	55,136	--	--	--
CET Three, LLC	4,698	--	--	--
Delta Group, Inc.	--	--	--	--
Ecovest, LLC	--	--	--	--
Elm Road Generating Station 1, LLC	--	--	--	--
Furniture Holdings, Inc.	88	88	3	3
GlassPack, LLC	2,247	2,247	--	--
Glenbrook Associates of Milwaukee Limited Partnership	2,567	2,567	--	--
Griffin Energy Marketing, LLC	--	--	--	--
Highland Best LLC	10,819	10,819	--	--

Wisconsin Energy Corporation
Assets and Employees Total and In-State
December 31, 2002

<u>Nonutility Affiliates (A)</u>	<u>Assets (000) (B) (C)</u>		<u>Employees</u>	
	<u>Total</u>	<u>Wisconsin</u>	<u>Total</u>	<u>Wisconsin</u>
Insulinde/Minergy V.o.f.	--	--	--	--
Juneau Avenue Partners LLC	11,091	11,091	--	--
LakeView Lodging LLC	10,182	10,182	--	--
Leasehold Capital Corporation	549	549	1	1
Meadowood Apartments Limited Partnership	5,533	5,533	--	--
Minergy Detroit, LLC	716	58	3	3
Minergy International B.V.	--	--	--	--
Minergy Neenah LLC	54,872	54,872	28	28
Neenah Housing Associates of Wisconsin, LLC	3,091	3,091	--	--
Port Washington Generating Station, LLC	--	--	--	--
Riverfront Power LLC	20,641	20,641	--	--
Syndesis Development Corporation	1,598	1,598	3	3
VIT B.V.	--	--	--	--
VIT B.V. & Co., C.V.	--	--	--	--
Wisvest Ther-Max, LLC	--	--	--	--
Androscoggin Energy LLC	170,146	--	--	--
Appleton Court Limited Partnership	2,226	2,226	--	--
ARI Network Services, Inc.	5,384	5,334	80	48
Badger Cement Products, LLC	10,962	10,962	--	--
Badger Energy, LLC	1	1	2	2
Blackhawk Energy Services, LLC	21,499	21,499	4	4
Commerce Power, LLC	803	803	--	--
Distribution Vision 2010, LLC	200	200	--	--
FRED-Germantown Land Development Limited Partnership	--	--	--	--
Historic King Place Limited Partnership	2,643	2,643	--	--
Housing Equity Fund 1992 Partnership	1,996	1,996	--	--
Kaztex Energy Management, Inc.	40,679	40,679	3	3
Lakeview Lot 96 LLC	6,194	6,194	--	--
Merrill City Hall Associates	880	880	--	--

Wisconsin Energy Corporation
Assets and Employees Total and In-State
December 31, 2002

<u>Nonutility Affiliates (A)</u>	<u>Assets (000) (B) (C)</u>		<u>Employees</u>	
	<u>Total</u>	<u>Wisconsin</u>	<u>Total</u>	<u>Wisconsin</u>
Limited Partnership				
MIBP Properties, LLC	775	775	--	--
Microelectronic Modules Corporation	12,453	12,453	100	98
Milwaukee West Development Limited Partnersl	5,699	5,699	--	--
Mound Avenue Associates LLC	5,130	5,130	--	--
Northwest X LLC	8,812	--	--	--
Nuclear Management Company, LLC	124,290	124,290	2,614	838
Paradise Place Associates Limited Partnership	1,920	1,920	--	--
ReGENco, LLC	7,991	7,991	97	93
Saukville Associates Limited Partnership	1,910	1,910	--	--
Southside Housing Partners I Limited Partnership	664	664	--	--
Southside Housing Partners II Limited Partnershi	566	566	--	--
Switch Power, Inc.	3,685	--	2	--
Wisconsin Equity Real Estate, LLC	516	516	--	--

(A) - Pursuant to Wisconsin Statute Section 196.795 definition.

(B) - Adjustments per Section 196.795(5) (p) 2. have not been made for intercompany investments or loans or minority ownership.

(C) - Asset amounts are the best numbers available at the time of this report. Certain affiliates (other than subsidiaries of Wisconsin Energy) have not finalized their balance sheets for 12/31/02 and therefore the asset amounts provided are subject to adjustment.

(D) - Includes investment in Wisconsin Electric Power Company, WICOR Inc., Edison Sault Electric Company and nonutility subsidiaries.

NOTE: Information for WICOR Inc. and its subsidiaries is omitted as they are exempt under Wisconsin Statutes 196.795 (8).

Wisconsin Energy Corporation
Third Tier Affiliates
December 31, 2002

3rd tier nonutility subsidiaries of WEC	Meets Condition 1	Meets Condition 2	Meets Condition 3	Meets Condition 4
CET Three, LLC			x	
Calumet Energy Team, LLC			x	
Juneau Avenue Partners, LLC	x			
VIT B.V.		x		

DEFINITIONS:

Condition 1: The nonutility affiliate will or does substantially retain, substantially attract or substantially promote business activity or employment or provides capital to businesses being formed or operating within the wholesale or retail service territory, within or outside of Wisconsin, of:

- a. Any public utility affiliate.
- b. Any public utility or member of a cooperative association organized under ch. 185 which files or has filed a plan under s. 196.491(2).

Condition 2: The nonutility affiliate will or does increase or promote energy conservation or develops, produces, or sells renewable energy products or equipment.

Condition 3: The nonutility affiliate will or does conduct a business that is functionally related to the provision of utility service or to the development or acquisition of energy resources.

Condition 4: The nonutility affiliate will or does develop or operate commercial or industrial parks in the wholesale or retail service territory of any public utility affiliate.

Wisconsin Energy Corporation
First Tier Affiliates
December 31, 2002

1st tier nonutility subsidiaries of WEC	Meets Condition 1	Meets Condition 2	Meets Condition 3	Meets Condition 4
Badger Service Co.			x	
Distribution Vision 2010, LLC			x	
Minergy Corp.		x		
Northern Tree Service, Inc.			x	
SSS Holdings, LLC	NA (a)	NA (a)	NA (a)	NA (a)
WE Power, LLC			x	
WEC Capital Trust I	NA (b)	NA (b)	NA (b)	NA (b)
WEC Capital Trust II	NA (b)	NA (b)	NA (b)	NA (b)
WEC International, Inc.		x		
WEC Nuclear Corp.			x	
Wisconsin Energy Capital Corp.	x			
Wisconsin Michigan Corp. (shell)	NA (c)	NA (c)	NA (c)	NA (c)
WISPARK LLC				x
WISVEST Corporation			x	
WITECH Corporation	x			

NOTES:

- (a) NA - Entity was formed to acquire and hold title to transportation and other business-related assets for common use by Wisconsin Energy Corporation and its affiliates.
- (b) N/A - These entities were established primarily for purchasing and/or selling securities or other cash management practices.
- (c) N/A - Entity was formed as a shell corporation in order to preserve the name Wisconsin Michigan. No activity at this time.

Definition of the conditions are listed on page 3.

Wisconsin Energy Corporation
Second Tier Affiliates
December 31, 2002

Appendix G

2nd tier nonutility subsidiaries of WEC	Meets Condition 1	Meets Condition 2	Meets Condition 3	Meets Condition 4
American Transmission Company LLC			X	
Androscoggin Energy LLC			X	
ATC Management Inc.			X	
Badger Cement Products, LLC	X			
Badger Energy, LLC			X	
Blackhawk Energy Services, LLC			X	
Bolingbrook Associates, LLC 1)	X			
Bostco LLC	X			
CET One, LLC			X	
CET Two, LLC			X	
Commerce Power, LLC	X			
Ecovest, LLC		X		
Elm Road Generating Station 1, LLC			X	
FRED-Germantown Land Development Limited Partnership	X			X
GlassPack, LLC		X		
Griffin Energy Marketing, LLC			X	
Highland Best LLC	X			
Insulinde/Minergy V.o.f.		X		
Kaztex Energy Management, Inc.			X	
LakeView Lodging LLC	X			
Lakeview Lot 96 LLC	X			
Leasehold Capital Corporation 1)	X			
MIBP Properties, LLC				X
Minergy Detroit, LLC		X		
Minergy International B.V.		X		
Minergy Neenah LLC		X		
Mound Avenue Associates, LLC	X			
NorthWest X LLC 1)	X			
Nuclear Management Company, LLC			X	
Port Washington Generating Station, LLC			X	
Riverfront Power LLC	X			
Syndesis Development Corporation 1)	X			
VIT B.V. & Co., C.V.		X		
Wisconsin Equity Real Estate, LLC	X			
Wisvest Ther-Max, LLC			X	
Wisconsin Energy Capital Corporation - other affiliates 2)	X			
WITECH affiliates 3)	X			

NOTES:

1) These affiliates provide a return of and a return on capital to Wispark so that Wispark may in turn pursue its ongoing primary mission of developing commercial and industrial parks in the wholesale or retail service territory of any public utility affiliate.

2) Wisconsin Energy Capital Corporation (WECC) affiliates consist of low income housing partnerships. WECC is satisfying condition 1 by investing in these affiliates.

3) WITECH Corporation satisfies condition 1 by providing capital to their affiliates and in turn promotes business activity or employment within WEC's public utility affiliates' service territory.

Definition of the conditions are listed on page 3.

Relative Statutes and Section of the Act

Wis. Stat. § 196.795(7)(a) provides that the Commission shall investigate the impact of the operation of every holding company system formed on or after November 28, 1985, on every public utility affiliate in the holding company system and shall determine whether each non-utility affiliate, does, or can reasonably be expected to do, at least one of the following:

1. Substantially retain, substantially attract, or substantially promote business activity or employment, or provide capital to businesses being formed or operating within the wholesale or retail service territory.
2. Increase or promote energy conservation or develop, produce, or sell renewable energy products or equipment.
3. Conduct a business that is functionally related to the provision of utility service or to the development or acquisition of energy resources.
4. Develop or operate commercial or industrial parks in the wholesale or retail service territory of any public utility affiliate.

Wis. Stat. § 196.795(7)(ar) provides that three years after the formation of a holding company under this section, the Commission shall report its findings under Wis. Stat. § 196.795(7)(a) to the legislature. Thereafter, the Commission shall submit to the legislature, a report on the impact of the holding company, including the benefits and adverse effects on every public utility affiliate in the holding company system and on the investors and consumers of such public utility affiliates, at least once every two years. The report shall include any recommendations for legislation relating to the regulation of any part of a holding company system.

Section 1(7) of Act 79 provides that the public interest and the interest of investors and consumers can be protected if:

- (a) Transactions between a public utility in a public utility holding company system and the holding company or its nonutility affiliates are subject to public service commission approval and regulation to assure that reasonable prices are charged and costs properly allocated.
- (b) The nonutility activities of the public utility holding company system do not substantially lessen competition, do not tend to create a monopoly or restrain trade and do not constitute an unfair business practice.
- (c) The public utility activities of a non-telecommunications public utility in a public utility holding company system remain subject to public service commission jurisdiction and regulation.
- (d) The activities of the public utility holding company system do not cause any materially detrimental effect on the public utility's rates for or reliability of utility service to the public, cost of capital or ability to raise capital.
- (e) The public service commission has access to the books and records of the public utility holding company system to the extent relevant for the commission to regulate any public utility in the system.
- (f) The provision of reliable and reasonably priced public utility service remains the predominant business of a public utility holding company system.